EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY AT THE TIME OF FILMING. IF AND WHEN A BETTER COPY CAN BE OBTAINED, A NEW FICHE WILL BE ISSUED.

(3)

. 85-568-ASX
atus: GRANTED

Title: Nantahala Power and Light Company, et al., Appellants
v.
Utilities Commission of North Carolina, et al.

cketed:
ptember 30, 1985 Court: Supreme Court of North Carolina

e also:
85-1165

Counsel for appellant: Lee, Rex

Counsel for appellee: Crisp, William T.

try	Date	Note	Proceedings and Orders
1	Sep 30 1985	G	Statement as to jurisdiction filed.
2	Jul 24 1985		Application for stay filed (A-74), and order granting same by Burger, C.J., on July 31, 1985
3	Sep 30 1985		Appendix of appellant Nantahala Power & Light Co. filed.
6	Oct 4 1985	G	Motion of Edison Electric Institute for leave to file a brief as amicus curiae filed.
8	Oct 22 1985		Order extending time to file response to jurisdictional statement until November 19, 1985.
9	Oct 30 1985		Brief amicus curiae of Tennessee filed.
0	Oct 30 1985		Brief amicus curiae of FERC filed.
2	Nov 19 1985		Brief amicus curiae of Highlands, NC filed.
3	Nov 20 1985		DISTRIBUTED. December 6, 1985
4	Nov 18 1985	G	Motion of United Steelworkers of America, AFL-CIO, Local Union 309 for leave to file a brief as amicus curiae filed.
5	Nov 21 1985	X	Motion of appellees N.C. Utilities Comm., et al. to dismiss or affirm filed.
6	Nov 27 1985	X	Reply brief of appellant Nantahala Power & Light Co. filed.
7	Dec 9 1985		Motion of Edison Electric Institute for leave to file a brief as amicus curiae GRANTED.
8	Dec 9 1985		Motion of United Steelworkers of America, AFL-CIO, Local Union 309 for leave to file a brief as amicus curiae GRANTED.
9	Dec 9 1985		PROBABLE JURISDICTION NOTED. Justice Powell OUT. **
:0	Jan 22 1986		Joint appendix filed.
:2	Jan 23 1986		Brief amicus curiae of Edison Electric Institute filed.
:3	Jan 23 1986		Brief amicus curiae of Tennessee filed.
:4	Jan 23 1986	G	Motion of Edison Electric Institute for leave to file a brief as amicus curiae filed.
:5	Jan 23 1986	G	Motion of New England Electric System for leave to file a brief as amicus curiae filed.
:6	Jan 23 1986		Brief amicus curiae of FERC filed.
:7	Jan 29 1986	G	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
:8	Feb 6 1986	D	Motion of appellees for divided argument filed.
:9	Feb 24 1986		Motion of Edison Electric Institute for leave to file a brief as amicus curiae GRANTED. Justice Powell OUT.
;0	Feb 24 1986		Motion of New England Electric System for leave to file

2/12

try	Date	Note	Proceedings and Orders
			a brief as amicus curiae GRANTED. Justice Powell OUT.
	Feb 24 1986		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED. Justice Powell OUT.
	Feb 24 1986		Motion of appellees for divided argument DENIED. Justice Brennan would grant this motion. Justice Powell OUT.
	Feb 22 1986		Brief of appellee N.C. Utilities Comm. filed.
	Feb 24 1986		Lodging received. 17 copies.
	Feb 21 1986		Brief amicus curiae of North Carolina Utilities Commission filed.
	Feb 22 1986		Brief amicus curiae of Highlands, NC filed.
	Feb 22 1986		Brief amicus curiae of Highlands, NC filed.
	Mar 14 1986		SET FOR ARGUMENT, Monday, April 21, 1986. (4th case)
	Mar 14 1986		CIRCULATED.
	Mar 27 1978		Record filed.
	Mar 27 1986		Certified copy of original record, 2 boxes, received.
	Apr 3 1986	X	Reply brief of appellant Nantahala Power & Light Co. filed.
	Apr 21 1986		ARGUED.

85-568 (1)

No. 85-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA ex rel.
UTILITIES COMMISSION; LACY H.
THORNBURG, Attorney General,
et al.,

Appellees.

On Appeal from the Supreme Court
of North Carolina

JURISDICTIONAL STATEMENT

REX E. LEE*
DAVID W. CARPENTER
SIDLEY & AUSTIN
1722 Eye St., N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Appellants

Of Counsel:
RONALD D. JONES
DAVID R. POE
M. REAMY ANCARROW
LEBOEUF, LAMB, LEIBY & MACRAE

EDWARD S. FINLEY, JR.
WILLIAM D. JOHNSON
GRADY L. SHIELDS
HUNTON & WILLIAMS

Counsel of Record

35pp

QUESTIONS PRESENTED

Under the Federal Power Act, the Federal Energy Regulatory Commission ("FERC") has exclusive jurisdiction to regulate wholesale electric rates and to allocate wholesale power supplies and their costs among different States. This case presents two closely-related questions involving the power of state regulatory commissions to nullify FERC's regulation and otherwise to burden the transmission and wholesale sale of electric power across state lines:

1. Whether the Federal Power Act permits a state regulatory commission, in setting retail rates within the state's borders, to reject the interstate wholesale cost and power allocations that FERC regulates and, in this case, actually approved?

2. Whether the Commerce Clause permits a state regulatory commission to give its citizens a "first call" preference on the inexpensive hydroelectric power generated in a multistate area?

PARTIES BELOW

The appellants in the North Carolina Supreme Court were Nantahala Power and Light Company, Tapoco, Inc., and Aluminum Company of America.

The appellees were State of North Carolina *ex rel.* Utilities Commission: Lacy H. Thornburg, Attorney General; Public Staff of the North Carolina Utilities Commission; Henry J. Truett; Town of Bryson City; Swain County Board of County Commissioners; Cherokee County; Graham County; Jackson County; Town of Andrews; Town of Dillsboro; Town of Robbinsville; Town of Sylva; Tribal Council of the Eastern Bank of Cherokee Indians; Muriel Maney; and Derol Crisp.

RULE 28.1 STATEMENT

Appellants Nantahala Power and Light Company and Tapoco, Inc. are each wholly-owned subsidiaries of Aluminum Company of America ("Alcoa"). Alcoa has no parent company. The companies (other than wholly-owned subsidiaries) in which Alcoa has ownership interest are listed in a supplemental statement that appears in the Appendix to the Jurisdictional Statement (345a–353a).

TABLE OF CONTENTS

APPENDICES*

*The Appendix to the Jurisdictional Statement ("App.") has been separately bound, pursuant to Rule 15(j).

TABLE OF AUTHORITIES

CASES

ADMINISTRATIVE DECISIONS

STATUTES

No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY, *et al.*,
Appellants,

v.

STATE OF NORTH CAROLINA *ex rel.* UTILITIES COMMISSION, *et al.*,
Appellees.

On Appeal from the Supreme Court of North Carolina

JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion and judgment of the North Carolina Supreme Court (Appendix ("App.") 1a–138a) is reported at 313 N.C. 614 and 332 S.E.2d 397. The opinion of the North Carolina Court of Appeals (App. 141a–164a) is reported at 65 N.C. App. 198 and 309 S.E.2d 473. The opinions of the North Carolina Utilities Commission, dated September 2, 1981 (App. 165a–235a), and January 28, 1982 (App. 236a–247a) are unreported. In addition, the pertinent portions of the following decisions of FERC that were issued in a parallel proceeding are reproduced in the Appendix: the FERC decision asserting jurisdiction over the allocation contract (App. 262a–266a), which is reported at 13 FERC ¶ 61,192 (CCH); the FERC Administrative Law Judge decision (App. 267a–282a), which is reported at 15 FERC ¶ 63,014 (CCH); FERC Opinion No. 139 (App. 283a–301a), which is reported at 19 FERC ¶ 61,152 (CCH); and FERC Opinion No. 139-A (App. 302a–313a), which is reported at 20 FERC ¶ 61,430 (CCH).

JURISDICTION

The final judgment of the North Carolina Supreme Court was entered on July 3, 1985. Nantahala's Notice of Appeal (App. 315a–316a) and Alcoa's Notice of Appeal (App. 317a) were each filed in the Supreme Court of North Carolina on July 23, 1985. Tapoco's Notice of Appeal (App. 318a) was filed on September 23, 1985. This Court has jurisdiction under 28 U.S.C. § 1257 (2). See *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375 (1983).[1]

CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution, Article VI, Clause 2: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . ."

The United States Constitution, Article I, Section 8, Clause 3: "The Congress shall have Power . . . [t]o regulate Commerce . . . among the several States . . . ."

The pertinent provisions of the Federal Power Act, 16 U.S.C. §§ 791a–828c, and of the North Carolina Public Utilities Act, N.C. Gen. Stat. §§ 62-1, *et seq.*, are reprinted at App. 248a–261a.

[1]In the case on appeal, the North Carolina Supreme Court held that the North Carolina Utilities Commission's investigation and disapproval of FERC-regulated wholesale cost allocations and determinations was required by a North Carolina statute (see App. 77a–80a) and rejected appellants' claims that such applications of this statute are preempted by federal law and contrary to the Commerce Clause. Further, state ratemaking orders, issued under delegated legislative authority, are themselves "state statutes" for purposes of 28 U.S.C. § 1257(2). See, *e.g., Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983); *Sultan Ry. & Timber Co.* v. *Department of Labor and Indus.*, 277 U.S. 135, 136 (1928); *Lake Erie & Western Ry. Co.* v. *State Pub. Utils. Comm'n*, 249 U.S. 422, 424 (1919).

STATEMENT OF THE CASE

Introduction

In the country today, wholesale electric power is commonly produced from different sources and then transmitted across multi-state service areas to local electric utilities that serve different States. Because this power has varying production costs, these arrangements inevitably produce controversies between States over how wholesale power supplies and their costs should be allocated. Each affected State would like to have as much as possible of the power that is inexpensive to produce and as little as possible of the high cost power.

Congress has granted FERC exclusive jurisdiction over these multi-state wholesale power and cost allocations and the resulting wholesale rates and costs. See App. 251a–257a. FERC's regulation thus determines the "wholesale costs" that each local utility incurs in obtaining power "for resale" to its customers.

This case presents a multi-state dispute over how wholesale power and its costs should be allocated and a square challenge to FERC's exclusive jurisdiction over these determinations.

Here, two different Alcoa subsidiaries sell electricity in two different States. Nantahala Power and Light Company ("Nantahala") serves retail customers and three wholesale customers in North Carolina. Tapoco, Inc. ("Tapoco") exclusively serves an Alcoa aluminum plant in Tennessee. Nantahala and Tapoco/Alcoa each has an inexpensive hydroelectric source of power as well as a supplemental expensive source of power, which costs about three times more. The allocation of the inexpensive power between the two companies and the two States is prescribed by wholesale rate schedules filed with FERC. FERC further has conducted extensive proceedings and approved allocations of the inexpensive power and its corresponding costs between Nantahala's North Carolina load and Tapoco's Tennessee load. The North Carolina Attorney General participated

in these FERC proceedings on behalf of Nantahala's retail customers.

However, in a separate proceeding in which North Carolina set Nantahala's retail rates, North Carolina refused to allow recovery of the wholesale costs allocated to Nantahala by the FERC rate schedules and power supply arrangements. Instead, North Carolina reallocated the economic benefits of the inexpensive power between the States and gave North Carolina customers a preference to this low cost hydroelectric power. North Carolina further ordered Tapoco's Tennessee customer (Alcoa) to pay a $29 million "refund" to Nantahala's customers in North Carolina.

The North Carolina Supreme Court here held that a state commission, in setting retail electric rates, has the discretion to disregard FERC-regulated and FERC-approved power and cost allocations and to refuse to allow recovery of the "wholesale costs" allocated to that State under the Federal Power Act. This decision conflicts with the holdings of numerous state supreme courts that, under this Court's "filed rate" doctrine, state commissions are bound by these FERC wholesale cost determinations and required to treat them as "reasonable operating expenses" attributable to intrastate retail service. *E.g., Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32, 38 (N.D. 1981); *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358, 1363 (1977), *cert. denied*, 435 U.S. 972 (1978); see pp. 14–20, *infra*. The North Carolina holding also conflicts with the recent Commerce Clause holding of the Eighth Circuit in *Middle South Energy, Inc.* v. *Arkansas Public Service Commission*, Nos. 84-2409, 84-2410, and 84-2480 (8th Cir., filed Aug. 23, 1985)[2], as well as this Court's decision in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982).

1. Background: The New Fontana Agreement And 1971 Apportionment Agreement. Nantahala, Tapoco, and the Tennessee Valley Authority ("TVA") are each engaged in the generation of hydroelectric power on the Little Tennessee River and its tributaries. Nantahala owns a number of plants in North Carolina. Tapoco owns two plants in Tennessee and two plants in North Carolina.[3]

In 1962, TVA, Nantahala, Tapoco, and Alcoa entered into what has been called the New Fontana Agreement (sometimes referred to as "NFA"). It provides that Nantahala and Tapoco would coordinate their electric production with the TVA system. App. 14a–15a, 28a–29a. Under this agreement, TVA controls the generation of power at Nantahala's and Tapoco's facilities, with all this electricity then delivered to TVA and dispatched over TVA's interstate system. In return, Nantahala and Tapoco collectively receive fixed entitlements to electric power, which consist of both "capacity entitlements" (in megawatts ("mW"))[4] and "energy entitlements" (in kilowat-hours ("kWh")).[5] See App. 14a–15a; 28a–29a; 216a. Because Nantahala and Tapoco trade their actual generation, which varies substantially with stream flow, for more consistently available TVA power, the TVA entitlements are less than Nantahala's and Tapoco's actual generation of electricity.

A 1971 Apportionment Agreement prescribes how the TVA entitlement power is divided between Nantahala and Tapoco.[6]

[2]Because the Eighth Circuit decision has not yet been reported, it is reproduced at pp. 319a–344a of the Appendix.

[3]Tapoco has a license under Part I of the Federal Power Act to operate its plants to supply power to the Alcoa aluminum plant in Alcoa, Tennessee. App. 272a–273a. Nantahala serves public customers, all of whom are located in western North Carolina. App. 273a.

[4]Capacity entitlements determine the amounts that Nantahala and Tapoco/Alcoa pay for peaking power. That is, the companies incur far greater costs per megawatt for the difference between (1) their peak demands (the particular hour and day when their consumptions are the highest) and (2) their capacity entitlements. See App. 28a, 31a.

[5]Energy entitlements determine the total amounts of energy that the two firms may obtain annually from TVA under the contracts. See App. 28a, 31a.

[6]Prior to 1971, Alcoa also purchased power from Nantahala, under a 1963 agreement that effectively defined Nantahala's share of the entitlements. App. 30a.

The New Fontana Agreement and 1971 Apportionment Agreement are interstate wholesale power exchange agreements and the arrangements under which Nantahala and Tapoco obtain power "for resale." The agreements are subject to FERC's jurisdiction under Part II of the Federal Power Act. See App. 262a–266a; see also App. 72a. FERC has denominated the New Fontana and 1971 Apportionment Agreements as Nantahala's FERC Wholesale Rate Schedule No. 1.[7] App. 72a.

Between 1962 and 1971, Nantahala's entitlements were sufficient to serve all the needs of Nantahala's public customers. App. 30a. However, the demand for electricity in western North Carolina has steadily increased and, in 1971, Nantahala began to purchase additional, more expensive power from TVA. By 1975, this additional expensive power cost 18.5 mils per kWh (App. 32a)—or more than three times the cost per kWh of the entitlement power (which is less than 6 mils per kWh). See Ex. RDB-R2; Tr. V.3 p. 3.[8]

In 1976, Nantahala sought to increase its rates. It filed a request with FERC to increase its charges to its three wholesale customers and a separate request with the North Carolina Utilities Commission to increase its charges to its retail customers. App. 7a, 269a. A common fact underlying both proceedings is that Nantahala's costs of obtaining power for resale to both its wholesale and its retail customers in North Carolina are determined by the FERC-regulated New Fontana and 1971 Apportionment Agreements. Nantahala's wholesale and retail customers thus each asserted claims that these agreements were unfair, that they should be modified or disregarded, and that greater

[7]These are also denominated Tapoco FERC Wholesale Rate Schedule No. 3. App. 72a, 263a.

[8]Nantahala bears its own costs of generation under the NFA. Thus, the unit cost of the entitlement power is determined by dividing Nantahala's costs of operating its generating facilities by the volume of the entitlement power allocated to Nantahala. In contrast, Nantahala pays for the power purchased from TVA.

amounts of inexpensive power should be allocated to North Carolina. However, these basic issues were considered by two tribunals: FERC, which has jurisdiction to consider them, and the North Carolina Utilities Commission, which does not. The two tribunals reached very different results.

2. The FERC Proceedings. In 1978, Nantahala's wholesale customers filed a formal complaint with FERC under Section 306 of the Federal Power Act. (See App. 257a). This complaint sought to set aside or modify the New Fontana and 1971 Apportionment Agreements under the provisions of Section 206 of the Act (See App. 256a–257a). The North Carolina Attorney General intervened in this FERC complaint proceeding on behalf of Nantahala's retail customers, and he participated fully in it.[9]

The retail and wholesale customers contended that Alcoa had manipulated the terms of the New Fontana Agreement and 1971 Apportionment Agreement to benefit Alcoa's aluminum production operations in Tennessee at the expense of Nantahala's North Carolina customers. After a five week evidentiary hearing before an Administrative Law Judge in which all the transactions among affiliates were carefully scrutinized (App. 267a–282a), FERC considered and rejected most of the North Carolina customers' claims.

FERC rejected the claims that the New Fontana Agreement was unfair to Nantahala and had improperly traded off the needs of Nantahala's wholesale and retail customers in North Carolina to benefit Alcoa's plant in Alcoa, Tennessee. App. 293a–295a. FERC found that there was "no intent [in the New Fontana Agreement] to ignore the needs of Nantahala's public service customers or deprive them of energy at just and reasonable rates." App. 295a. It thus treated this agreement as establishing the en-

[9]The complaint proceeding was consolidated with Nantahala's separate 1976 request for an increase in the rates to its three wholesale customers. See p. 6, *supra*.

titlements to inexpensive power which Nantahala and Tapoco could divide. FERC also rejected the claims that Alcoa "used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act" and that the two entities operated as a single integrated system. App. 291a.

FERC approved the 1971 Apportionment Agreement's allocation of 54.3 mW of capacity to Nantahala. App. 297a. However, FERC concluded that Nantahala should have received an additional 44 million kWh in energy entitlements. App. 297a. FERC then affirmed the Administrative Law Judge's conclusion that the "just and reasonable rates and charges are those which are in conformity with the findings and conclusions set forth in [its] decision." App. 282a; see App. 301a.

Nantahala's retail customers, again represented by the North Carolina Attorney General, and Nantahala's wholesale customers each appealed these FERC determinations to the United States Court of Appeals for the Fourth Circuit. The Fourth Circuit affirmed FERC. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984).

3. The NCUC Proceedings. In the retail rate case, the North Carolina Utilities Commission ("NCUC") had initially agreed that Nantahala's costs of obtaining power for resale were determined by the FERC-regulated rate schedules and power supply agreements. However, in 1980, the North Carolina Supreme Court remanded Nantahala's rate case to the NCUC to consider whether the contractual arrangements are "in the best interests of the customers of Nantahala." *North Carolina ex rel. Utilities Commission.* v. *Edmisten*, 299 N.C. 432, 434, 263 S.E.2d 583, 586 (1980). The North Carolina Supreme Court further stated that Nantahala's "public customers . . . have, in effect, 'first claim' on all energy actually generated by Nantahala's facilities." 299 N.C. at 438, 263 S.E.2d at 588. On remand, in 1981, the

NCUC proceeded to consider the very cost and power allocation issues that were then being litigated before FERC.[10]

The NCUC responded to the North Carolina Supreme Court's instruction to promote the "best interests" of Nantahala's North Carolina customers by rejecting the allocation of the inexpensive power prescribed by the FERC-regulated agreements and reallocating the economic benefit of this power as if the FERC-regulated New Fontana and 1971 Apportionment Agreements did not exist.[11] Instead, the NCUC adopted a method that it described as a "first call" preference for "North Carolina['s] public load [to] the total electric energy output of the combined system," with only the "excess [to] be available for sale [to] Alcoa" in Tennessee. App. 183a; see also App. 240a. The NCUC acknowledged that it effectively rescinded the FERC-regulated agreements by stating that its action was "nicely suited as a proper alternative to reformation of the [FERC-regulated] contracts." App. 202a.

The NCUC's "first call" preference for North Carolina gives Nantahala a proportionately higher and ever-increasing percentage of the economic benefits from the hydroelectric power that

[10]Alcoa and Tapoco filed suit in federal district court on January 25, 1982 (prior to the final NCUC decision) seeking to enjoin threatened NCUC action on the ground that it interfered with the operation of the Federal Power Act and impermissibly burdened interstate commerce. The District Court and Fourth Circuit held that abstention principles precluded the District Court from adjudicating these claims. See *Aluminum Company of America* v. *Utilities Comm'n*, 713 F 2d 1024, 1028-30 (4th Cir. 1983). This Court denied Alcoa's petition for *certiorari* with Justices Brennan and White noting that they would have granted the petition. 104 S. Ct. 1326 (1984).

[11]Indeed, the NCUC disregarded the NFA on the basis of the NCUC's explicit finding that the NFA "is structured to meet Alcoa's demand" in Tennessee rather than the needs of the North Carolina public load. App. 197a. This was contrary to the Administrative Law Judge's earlier finding that the NFA is fair to both States (see App. 275a), which FERC would affirm four months after the NCUC's order was entered. See pp. 7-8, *supra*; App. 293a-295a.

Nantahala's and Tapoco's facilities generate.[12] This preference has three interrelated aspects. First, the NCUC combined or "rolled-in" the companies' power supplies and costs, but excluded the expensive power that Alcoa purchased from TVA.[13] App. 211a. Second, the NCUC used Nantahala's total (and ever-increasing) demand for power—not Nantahala's contribution to the low-cost power supply—to determine Nantahala's percentage share of the cheap power.[14] Third, and most significant of all, Nantahala's total share of the power is determined by applying Nantahala's assumed percentage share—and only Nantahala's—not to Nantahala's and Tapoco's entitlements under the New Fontana Agreement, but rather to hypothetical larger amounts that include electricity that is not available to either Tapoco or Nantahala under the NFA.[15] Because Tennessee receives only the remaining power (see App. 220a–221a; see also App. 68a–69a), this formula sets rates on the basis of an absolute preference for North Carolina to the inexpensive power. Indeed, because NCUC treated Nantahala as entitled to ever-increasing percentages of both Nantahala's and Tapoco's power, the NCUC preference extends to hydroelectric power generated in Tennessee as well as power generated in North Carolina.

[12]The Intervenor witness who advocated this approach testified that, under his projections for the growth in Nantahala's demand, there would be no inexpensive power left for Tennessee within 8 years. Tr. V.7, pp. 38–39.

[13]Tapoco/Alcoa and Nantahala together have four sources of power. Two of them are low-cost and two are not. They are: 1) Nantahala's entitlements from TVA, 2) Tapoco's entitlements from TVA, 3) Nantahala's purchases from TVA, and 4) Alcoa's purchases from TVA delivered to it by Tapoco. The Commission "rolled-in" only the first three. It left out Alcoa's expensive purchases from TVA (App. 211a, see App. 66a) and thereby assured that North Carolina's share of the low cost power would be inflated.

Because Alcoa's average cost of power (*i.e.*, entitlements plus separate power purchased from TVA) is higher than Nantahala's (see Tr. V. 14, p. 70), a complete roll-in of Nantahala and Tapoco into a single hypothetical combined system would have increased the average cost of power resold in North Carolina and disadvantaged North Carolina's customers. See App. 66a.

[14]NCUC determined Nantahala's capacity allocation by dividing *its peak load requirements* in the given test year (there, 105.7 mW) by the sum of the total generating capability of Nantahala and Tapoco and the additional capacity that Nantahala purchased from TVA in that year. See App. 219a–220a; see also App. 68a. This percentage share bears no relationship to the proportionate contribution that Nantahala's generation makes to TVA entitlements under the NFA. Therefore, as Nantahala's peak load requirements increase in future years—as they have—so too will its percentage of the inexpensive capacity entitlements—as it has in subsequent Nantahala rate cases. See p. 11, n.16, *infra*.

As the North Carolina Supreme Court stated, the "practical effect" of the NCUC Order is that Nantahala was barred from recovering all of the wholesale costs "associated with" the FERC-regulated NFA and 1971 Apportionment Agreement. See App. 69a. Specifically, the NCUC set rates on the basis of an entirely different allocation of the inexpensive power and the related wholesale costs than under the FERC-regulated and FERC-approved rate schedules. Whereas those schedules allocate 54.3 mW of capacity entitlements to Nantahala and its public customers in North Carolina, the NCUC allocated them 92.7 mW (24.6% of 376.9 mW) of low cost capacity in the 1975 "test year" (App. 219a-220a), with this allocation to increase in future test years.[16] The NCUC also allocated more inexpensive energy to Nantahala than had FERC. Compare App. 220a-221a with App. 297a. The NCUC thereby reduced Nantahala's assumed average wholesale cost of power far below the actual cost established by the FERC-regulated rate schedules. This, as stated by the North Carolina Supreme Court, resulted in a corresponding increase in

[15]Thus, the NCUC assumed that Nantahala and Tapoco had a total of 376.9 mW of inexpensive hydroelectric power (App. 219a), which is greatly in excess of the 218.3 mW in capacity entitlements provided by the NFA. See p. 5, *supra*.

[16]Indeed, in a subsequent rate case, the NCUC applied the same approach to allocate to North Carolina 100.1 mW of capacity. See *North Carolina ex rel. Util. Comm'n* v. *Nantahala Power and Light Co.*, No. 111A84 (S.Ct. N.C., filed Aug. 13, 1985). The greater allocations resulted from intervening increases in the demand and needs of the North Carolina customers. See p. 10, n.14, *supra*.

the costs "effectively allocated" to Tapoco and its customer in Tennessee. See App. 69a–70a.

As a result of this dramatic reduction in Nantahala's assumed wholesale unit costs, the NCUC ordered reductions in Nantahala's retail rates and a refund of some $29 million (including interest) to Nantahala's retail customers in North Carolina. See R. 380–81. Because this substantially exceeds Nantahala's net worth, the NCUC has ordered Alcoa,[17] as the "beneficiary" of the FERC-regulated agreements, to fund the refunds to the extent that Nantahala may not do so without impairing its capital.[18] App. 178a–179a. NCUC has, in short, ordered the Tennessee customer of Tapoco to refund money to Nantahala's North Carolina customers.

Not only is the ordered "refund" in excess of Nantahala's net worth, but the continuing application of the NCUC's method, which the North Carolina Supreme Court has essentially mandated in subsequent decisions,[19] has brought the current refund amount to approximately $45,000,000. These refunds and North Carolina's ongoing expropriations of the economic benefits of the Tapoco hydroelectric power endanger the continuation of aluminum production at Alcoa's Tennessee plant.

[17]Alcoa was involuntarily made a party to these NCUC proceedings in 1981, after the case was remanded to it by the North Carolina Supreme Court, on the theory that it is a North Carolina "public utility" and part of the "Alcoa system." App. 9a, 232a. No attempt was made to square this finding with the exclusion of Alcoa's purchased power from the hypothetical rolled-in system. See p. 10, n.13.

[18]Under the NCUC approach, Alcoa is required to pay for all the expensive TVA power purchased for its own needs and for approximately 75% of the expensive TVA power purchased by Nantahala to serve North Carolina's customers. See App. 220a–221a.

[19]*North Carolina ex rel Utils. Comm'n* v. *Nantahala Power and Light Co.*, No. 111A84 (S. Ct. N.C., filed Aug. 13, 1985); see also *North Carolina ex rel. Utils. Comm'n* v. *Edmisten*, No. 549A84 (S. Ct. N.C., filed Aug. 13, 1985).

4. The North Carolina Supreme Court's Decision. The North Carolina Supreme Court affirmed the NCUC order in a 132 page opinion. It rejected the appellants' arguments that the NCUC order invaded FERC's exclusive jurisdiction under the Federal Power Act (App. 73a–98a) and violated the Commerce Clause (App. 98a–106a).

First, the North Carolina Supreme Court reasoned that, despite the Federal Power Act, state commissions retained jurisdiction to investigate interstate wholesale power and cost allocations and "to do exactly what the [NCUC] has done in the instant case: determine that certain of a utility's [wholesale] costs were effectively incurred for the benefit of its shareholder, not its retail consumers," and disallow those wholesale costs. App. 84a. The North Carolina Supreme Court held that the application of the state statutes requiring such investigations and disallowances (App. 78; see N.C. Gen. Stat. § 62–133, App. 258a–261a) had not been preempted by the Federal Power Act.

Second, the North Carolina Supreme Court rejected the contentions that the NCUC order granted North Carolina citizens an economic preference, contrary to the Commerce Clause. The North Carolina Court asserted that its citizens did not have a true "first call" on the inexpensive power because the economic benefits of *all* the hydroelectric power had not been reserved to them, and the exportation of power, as such, had not been banned. It further held that the NCUC order had only an incidental effect on interstate commerce. App. 100a–102a, 105a.

The North Carolina Supreme Court refused to stay its order. App. 139a–140a. On July 31, 1985, the Chief Justice of the United States granted appellants' application for a stay, pending this Court's ruling on appellants' Jurisdictional Statement.

THE QUESTIONS PRESENTED ARE SUBSTANTIAL

The North Carolina Supreme Court stated that "[t]his appeal raises substantial questions" under the Supremacy Clause and

the Commerce Clause of the Federal Constitution. App. 12a. This statement is correct. The North Carolina Supreme Court's holding that the Federal Power Act does not preempt a state utility commission's jurisdiction to investigate interstate power allocations and disallow wholesale costs required by FERC wholesale rate schedules, conflicts with this Court's "filed rate" doctrine and the holdings of state supreme courts, such as *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981), *Narragansett Electric Power Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1981), and their progeny. North Carolina's Commerce Clause holding further conflicts with the Eighth Circuit's recent decision in *Middle South Energy, Inc.* v. *Arkansas Public Service Commission* (App. 319a-344a), as well as this Court's decision in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1981).

Resolution of these conflicts is a matter of great national importance. Contractual arrangements in which wholesale electric power is transferred to the interstate grid from different sources (with different costs) and then resold in different States are very common; they are the rule, not the exception. State commissions, like the NCUC, are increasingly attempting to impose a wholesale "rate structure" and an allocation of costs between States that will "benefi[t] its residents to the detriment of its neighbors."[20] A decision by this Court will thus affect many cases. The issues should be resolved now. Many financial and planning decisions are being made in reliance on FERC's exclusive jurisdiction over these arrangements.

I. THE FEDERAL POWER ACT PREEMPTS NORTH CAROLINA'S APPLICATION OF ITS STATUTES.

In the Federal Power Act, Congress sought to assure that the transmission of electric power in interstate commerce and sales of power at wholesale would not be burdened by hostile or inconsistent state regulation. Congress recognized that exclusive federal jurisdiction over these arrangements is important to the national economy. It assures that state action will not impair interstate exchanges of power or impede the ability of suppliers of wholesale power to recover all the costs reasonably incurred in producing that power through wholesale rates. Congress thus gave the Federal Power Commission (now FERC) the exclusive jurisdiction to regulate the rates for sales of electric energy "for resale," to regulate the "transmission of electric energy in interstate commerce," and to allocate wholesale power supplies and their costs among different states and the local utilities serving them. See Section 201 of the Act, App. 251a; see also App. 249a–251a. The rate schedules filed with or approved by FERC, in turn, determine the "wholesale costs" that local utilities incur in obtaining power for resale in their respective States or service areas.

[20] *Massachusetts* v. *United States*, 729 F.2d 886, 888-89 (1st Cir. 1984); see *Middle South Energy, Inc.* v. *Arkansas Public Utils. Comm'n*, *supra*; see pp. 19-20 & n.29, *infra*.

Here, the North Carolina Supreme Court has held that, despite these provisions, state regulatory commissions have essentially unlimited discretion, in setting retail rates, to disregard FERC's jurisdiction and determinations and to refuse to permit local utilities to recover all the costs incurred under FERC's wholesale rate schedules in their retail rates. Under North Carolina's holding, a local commission may do so whenever it finds, after an independent investigation, that interstate power supply arrangements are unreasonable or that the wholesale costs incurred under the rate schedules benefited customers in other states or the utilities' shareholders, and not local ratepayers. App. 84a–85a, 69a–70a. North Carolina's holding conflicts with the prior decisions of this Court and the decisions of many state supreme courts and federal courts of appeals.

This Court has held that the Federal Power Act (and the Natural Gas Act, 15 U.S.C. §§ 717–717w) preempt state commissions from regulating "directly" or "indirectly," the interstate wholesale rates and the cost and power allocations that are sub-

ject to FERC's jurisdiction. *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84, 93–94 (1963); see *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215-16 (1964); *Maryland* v. *Louisiana*, 451 U.S. 725, 746–52 (1981) (state law preempted if its "effect" is to interfere with FERC's authority to regulate the proper allocation of costs). The Court established the "filed rate" doctrine to assure that provisions of state law may not have the effect of altering wholesale rates that are regulated or approved by FERC—as the NCUC order did here. As this Court stated in *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951), state commissions and utilities alike:

> "can claim no rate as a legal right that is other than the filed rate, *whether fixed or merely accepted by the Commission, and not even a court can authorize commerce in the commodity on other terms*. . . .
>
> [T]he right to a reasonable rate is the right to the rate which the [FERC] files or fixes and . . . the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one."

Id. at 251–52 (emphasis supplied). Any departure from this principle would impair the Congressional objective of assuring the full recovery of all costs reasonably incurred in producing and distributing wholesale power in interstate commerce.[21] Thus, the Court has held that rates "filed with" or "fixed by" FERC must be treated as just and reasonable charges for all purposes and that neither state contract law nor other provisions of state law can be

[21]Indeed, these principles have special applicability here, where a State has attempted to reallocate power and its costs to benefit its own citizens. The Federal Power Act was enacted as a "direct result" of this Court's holding in *Public Utils. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927), and its recognition that States could burden sales of power across state lines by allocating interstate wholesale costs to advance their "respective local interests." *Id.* at 89–90. See *Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 378 (1983).

applied to subvert wholesale rate schedules thus established under FERC's jurisdiction. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 578–80 (1981). As this Court has further stated:

> "Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction making unnecessary . . . case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce . . . ."

FPC v. *Southern California Edison Co.*, 376 U.S. 205, 215–16 (1964).

North Carolina has crossed over this "bright line." The NCUC order effectively nullified FERC's cost and power allocations between North Carolina and Tennessee and modified the wholesale rate schedules that were regulated and approved by FERC.[22] To be sure, there was a factual dispute over the fairness of the New Fontana and 1971 Apportionment Agreements and, therefore, their appropriateness as power supply arrangements determining Nantahala's wholesale costs. But the purposes of the Federal Power Act require that this factual issue be resolved by a disinterested Federal agency, not an affected State, and that FERC engage in any balancing of the interests of customers in the respective States—as FERC here did. The filed rate doctrine preempted North Carolina from looking behind FERC's wholesale rate schedules. Thus, the fact that the NCUC made a factual finding that the agreements unfairly benefited Alcoa's Tennessee aluminum plant over North Carolina ratepayers is irrelevant. The state commission's jurisdiction to make this investigation is preempted by the Federal Power Act. Were the law otherwise, any state could thwart the objectives of the Federal Power Act at

[22]As the North Carolina Supreme Court stated, the "practical effect" of the NCUC order was that wholesale "costs" attributed to North Carolina's public load by the FERC wholesale rate schedules and "actually incurred by the unified system under the agreements were *effectively allocated* for ratemaking purposes to the systems' industrial customer" in Tennessee. App. 69a–70a (emphasis added).

will; a state commission can always find that some portion of wholesale costs should be shifted to customers in another State. These considerations are acute where, as here, FERC conducted extensive proceedings under Section 206 of the Act, made different findings, and expressly approved different interstate allocations of the power and wholesale costs. See pp. 7–8, *supra.*

State supreme courts and federal courts of appeals are almost uniformly in conflict with the North Carolina Supreme Court's holding. They hold that "[FERC] has exclusive jurisdiction over interstate wholesale rates,"[23] that the Federal Power Act preempts a State's jurisdiction over wholesale arrangements, and that "[s]tate and local commissions have no authority . . . to inquire into the reasonableness of wholesale rates, but must allow them as reasonable operating expenses" in setting retail rates[24]—as the NCUC refused to do here.[25] Similarly, these courts hold that state

[23]*Narragansett Elec. Co.* v. *Burke,* 119 R.I. 559, 567, 381 A.2d 1358, 1362 (1977), *cert. denied,* 435 U.S. 972 (1978); *accord, Northern States Power Co.* v. *Hagen,* 314 N.W.2d 32, 36–37 (N.D. 1981); *Northern States Power Co.* v. *Minnesota Pub. Serv. Comm'n,* 344 N.W.2d 374, 377-78 (Minn. 1984), *cert. denied,* 104 S. Ct. 3546 (1984).

[24]*Washington Gas Light Co.* v. *Public Serv. Comm'n,* 452 A.2d 375, 385–86 (D.C. App. 1982), *cert. denied,* 462 U.S. 1107 (1983); *accord, Public Serv. Co.* v. *Public Utils. Comm'n,* 644 P.2d 933, 939–40 (Colo. 1982); *City of Chicago* v. *Illinois Commerce Comm'n,* 13 Ill. 2d 607, 616 150 N.E.2d 776, 780–81 (1958).; *United Gas Corp.* v. *Mississippi Pub. Serv. Comm'n.,* 240 Miss. 405, 440–43, 127 So. 2d 404, 418–20 (1961).

[25]The conflict is thus not diminished in the slightest by the fact that some of these state supreme courts also have held that increases in FERC-regulated rates need not always *automatically* be passed through to consumers under fuel adjustment clauses. They reason that while the FERC-regulated wholesale costs must be treated as reasonable operating expenses and recovered, a state commission may find, in a general rate case, that increases in the wholesale rates were offset by savings in other aspects of the utility's business. *Compare Narragansett Elec. Co.* v. *Burke, supra,* 119 R.I. at 568, 381 A.2d at 1363, *with* App. 82a–84a. The decisive fact is that here the NCUC, in a general rate case, disallowed as operating expenses the wholesale costs and power supply arrangements for serving North Carolina customers that FERC approved. The NCUC did not find offsetting savings; nor could it.

commissions may not investigate FERC's underlying wholesale power and cost allocation determinations—as NCUC did here.[26] Finally, each decision conflicts with the North Carolina Supreme Court's conclusion that state commissions may disallow costs assigned to them by FERC's regulation whenever the state commission disagrees with FERC that the costs were incurred for the "benefit" of ratepayers in that state. *E.g., Washington Gas Light Co.* v. *Public Service Commission, supra,* 452 A.2d at 386.

These and other courts have held that where, as here, a state commission believes wholesale power and costs are being unreasonably allocated among different states, its *exclusive* remedy is to participate in FERC proceedings that seek relief under Section 206 of the Federal Power Act—as the North Carolina Attorney General did here—and thereby permit a neutral federal agency to balance the interests of the respective States and customers. *Massachusetts* v. *United States,* 729 F.2d 886, 888 (1st Cir. 1984); see *Utah* v. *FERC,* 691 F.2d 444, 448 (10th Cir. 1982); *Middle South Energy, Inc.* v. *Arkansas Public Service Commission,* 593 F. Supp. 363, 366–67 (E.D. Ark. 1984), *aff'd on other grounds,* Nos. 84-2409, 84-2410, and 84-2480 (8th Cir.,

[26]See *Northern States Power Co.* v. *Minnesota Pub. Serv. Comm'n,* 344 N.W.2d 374, 381 (Minn. 1984), *cert. denied,* 104 S. Ct. 3546 (1984); *Northern States Power Co.* v. *Hagen,* 314 N.W.2d 32, 38 (N.D. 1981); *Office of Public Counsellor* v. *Indiana & Michigan Elec. Co.,* 416 N.E.2d 161, 165 (Ind. App. 1981). The North Carolina Court's assertion that the two *Northern States* decisions allow a state commission to permit recovery of only that portion of the FERC-determined wholesale costs that the state commission finds benefit "intrastate retail customers" for ratemaking is wrong. App. 86a. On the contrary, *Northern States* squarely rejected that argument, reasoning that:

> "[I]t would frustrate the purpose of Congress in establishing reasonable wholesale rates if the reasonableness of these rates as an operating expense were inquired into by and made subject to the North Dakota PSC in establishing reasonable retail rates."

314 N.W.2d at 38. In short, there is no principled basis for distinguishing the *Northern States* decisions from this case.

filed Aug. 23, 1985), App. 319a–344a.[27] The state commission may not seek to nullify or modify the interstate wholesale cost and power allocations through any means, direct or indirect, and assuredly may not collaterally attack an explicit FERC determination made after a full hearing in which the State itself participated.

Although the North Carolina Supreme Court decision conflicts with each of the foregoing state and federal decisions, there is one lower court decision that may be consistent with North Carolina's position.[28] There is also a growing number of state utility commission decisions that follow North Carolina's approach.[29] Indeed, the growing uncertainty in this area of the law, *despite* this Court's decisions in *Montana-Dakota* and its progeny, accentuates the need for review of the Federal Power Act issue and makes it essential that this Court decide this issue now.

[27] In this respect as in others, this case is identical to the *Middle South Energy, Inc., supra,* though for reasons discussed below, the Eighth Circuit Court of Appeals did not reach the preemption question. See p. 22, *infra.*

[28] *Pike County Light & Power Co.* v. *Pennsylvania Pub. Util. Comm'n,* 77 Pa. Commw. Ct. 268, 465 A.2d 735 (1983); compare *Appeal of Sinclair Machine Prods., Inc.,* No. 84-380 (S.Ct. N.H., filed July 26, 1985).

[29] See, *e.g.*, *Mississippi Power and Light Co.*, P.S.C. Miss. Case No. U-4620, Final Order on Rehearing (Sept. 16, 1985) (state commission partial disallowance of costs incurred under FERC-regulated rate schedules); *Louisiana Power & Light Co.,* L.P.S.C. Order No. U-16513-A (Sept. 13, 1985) (state commission denial of pass through of costs incurred under FERC-established power purchase cost allocation); *New Orleans Pub. Serv. Inc.*, City of New Orleans Council, Resolution R-85-526 (Sept. 5, 1985) (city council partial disallowance of costs incurred under FERC-established power purchase cost allocation); *Appalachian Power Co.*, P.S.C. W. Va. Case No. 83-697-E-42T, Order (Dec. 28, 1984) (state commission disallowance of pass through of costs incurred under FERC-regulated transmission agreement, pending separate state review and approval); *General Adjustment in Electric Rates of Kentucky Power Co.*, Ky. P.S.C. Case No. 9061, Opinion and Order (Dec. 4, 1984) (state commission restriction of incurrence of costs under FERC-regulated interstate transmission agreements).

II. THE NCUC DECISION VIOLATES THE COMMERCE CLAUSE.

Even apart from the Federal Power Act, the NCUC order violates the Commerce Clause. Indeed, this aspect of the North Carolina Supreme Court's decision squarely conflicts with the Eighth Circuit's recent decision in *Middle South Energy, Inc.* v. *Arkansas Public Service Commission* (8th Cir., filed Aug. 23, 1985) (App. 319a–344a), and with this Court's decision in *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982).

The NCUC order gives North Carolina customers a disproportionate and ever-increasing preference to the economic benefits of inexpensive hydroelectric power generated in Tennessee and North Carolina. See pp. [illegible] 12, *supra.* The NCUC has also required Tapoco's Tennessee customer to pay "refunds" equivalent to the higher cost of power it has allocated to Tennessee. The order thereby explicitly transfers economic benefits from Alcoa's plant in Tennessee to Nantahala's North Carolina customers and inhibits the exportation of hydroelectric power generated in North Carolina to Tennessee.

This is the kind of direct burden on interstate commerce that has been held to be almost *per se* invalid. *New England Power Co.* v. *New Hampshire, supra* 455 U.S. at 338–39; *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927); *cf. Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 394 (1983) (Commerce Clause challenge rejected where affected sales were intrastate). Further, by giving North Carolina customers the equivalent of a preference on power generated in Tennessee and requiring payments from a Tennessee customer, North Carolina has engaged in the extra-territorial regulation of commerce that, too, has been held invalid. See *Edgar* v. *MITE Corp.*, 457 U.S. 624, 640 (1982) (plurality opinion). In all events, the fact that the NCUC order burdens the movement of things of value across state lines precludes the North Carolina Court's attempt to characterize the burdens on commerce as "incidental." See App. 105a.

Furthermore, the basis of the NCUC decision was that it was required, by the North Carolina Supreme Court's earlier mandate, to adopt this allocation if it was in the "best interests" of *North Carolina's* customers and to give those North Carolina customers the equivalent of a "first call" preference on hydroelectric power generated in that State. See pp. 8-9, *supra*. The NCUC fully implemented this mandate by making the reservation of economic benefits for North Carolina customers the test of the "proper" allocation of the inexpensive power and giving North Carolina customers preference to the power generated in Tennessee as well as in North Carolina. See pp. 9-12, *supra*. In short, the purpose as well as the effect of the NCUC's order was to preserve the benefits of inexpensive power for Nantahala's North Carolina customers, regardless of the interests of Tennessee. This constitutes precisely the kind of economic protectionism that is virtually *per se* unconstitutional under the Commerce Clause. *Philadelphia* v. *New Jersey*, 437 U.S. 617, 624, 628 (1978).

Like the instant case, the Eighth Circuit's recent decision in *Middle South Energy, Inc.* v. *Arkansas Public Service Commission, supra*, involved a state commission proceeding that threatened to nullify certain FERC-regulated wholesale power supply and cost allocations and effectively to reallocate those costs to benefit local ratepayers. Middle South is a holding company whose four subsidiaries provide electricity in several different states, including Arkansas. Another Middle South subsidiary has constructed a nuclear generating facility whose costs of power are higher than other Middle South companies' costs. As in the instant case, FERC has made an allocation of the power supply and the resulting wholesale costs among the States and respective utilities. And as in the instant case, Arkansas was attempting to impose a different allocation, under which Arkansas would be allocated none of the high cost power. App. 330a.

Because it wished to avoid a question (not presented here) under the Public Utility Holding Company Act, the Eighth Circuit did not decide the question whether the Federal Power Act preempted the state commission's assertion of jurisdiction. App. 330a-331a. Instead, the court held that the commission order violated the Commerce Clause because, like the NCUC order, the Arkansas commission order had the purpose or the effect of shifting cost burdens to citizens in other states and gaining "a preference for citizens in the regulating jurisdiction . . . at the expense of out-of-state customers." App. 341a. Contrary to the North Carolina Supreme Court's holding in this case, the Eighth Circuit held that the resulting burdens on the operation of the interstate grid is not incidental; but is a "direct and substantial burden on . . . commerce that is interstate in a most basic form." App. 341a.

New England Power Co. v. *New Hampshire, supra*, is also indistinguishable from the present case. There, as here, the New Hampshire Commission ordered that retail electric rates within New Hampshire be set as if the inexpensive hydroelectric power that had been exported to other states were consumed in New Hampshire, effectively preserving the benefits of New Hampshire power for New Hampshire residents. 455 U.S. at 336-37 n. 3 & 339. This Court held that this order, like the NCUC order, imposed a substantial burden on the transmission of power in interstate commerce and epitomized the protectionism that the Commerce Clause prohibits. 455 U.S. at 339. Because New Hampshire did not seek to prevent the physical exportation of power any more than North Carolina has, this case cannot be distinguished. Compare App. 100a-101a. Indeed, the instant case is more egregious than *New England Power* because the NCUC order gives North Carolina preferential benefits to hydroelectric power produced in Tennessee as well as to the power generated in North Carolina.

CONCLUSION

The Court should note jurisdiction and set the case for full briefing and argument on the merits. The federal issues are too substantial, and have too large an impact on Tennessee and other States, for the North Carolina courts and regulators to be the only tribunals to consider them.

Respectfully submitted,

REX E. LEE*
DAVID W. CARPENTER
SIDLEY & AUSTIN
1722 Eye St., N.W.
Washington, D.C. 20006
(202) 429-4000

Counsel for Appellants

Of Counsel:
RONALD D. JONES
DAVID R. POE
M. REAMY ANCARROW
LEBOEUF, LAMB, LEIBY & MACRAE

EDWARD S. FINLEY, JR.
WILLIAM D. JOHNSON
GRADY L. SHIELDS
HUNTON & WILLIAMS

Dated: September 30, 1985

**Counsel of Record*

85-568 (2)

No. 85-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA ex rel.
UTILITIES COMMISSION; LACY H.
THORNBURG, Attorney General,
et al.,

Appellees.

On Appeal from the Supreme Court
of North Carolina

APPENDIX TO JURISDICTIONAL STATEMENT

REX E. LEE*
DAVID W. CARPENTER
SIDLEY & AUSTIN
1722 Eye St., N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Appellants

Of Counsel:
RONALD D. JONES
DAVID R. POE
M. REAMY ANCARROW
LEBOEUF, LAMB, LEIBY & MACRAE

EDWARD S. FINLEY, JR.
WILLIAM D. JOHNSON
GRADY L. SHIELDS
HUNTON & WILLIAMS

*Counsel of Record

356

TABLE OF CONTENTS

APPENDIX A

Opinion Of The North Carolina Supreme Court

STATE OF NORTH CAROLINA, EX REL. UTILITIES COMMISSION; RUFUS L. EDMISTEN, ATTORNEY GENERAL; PUBLIC STAFF; HENRY J. TRUETT; TOWN OF BRYSON CITY; SWAIN COUNTY BOARD OF COUNTY COMMISSIONERS; CHEROKEE, GRAHAM AND JACKSON COUNTIES, THE TOWNS OF ANDREWS, DILLSBORO, ROBBINSVILLE, AND SYLVA; THE TRIBAL COUNCIL OF THE EASTERN BAND OF CHEROKEE INDIANS; MURIEL MANEY; AND DEROL CRISP v. NANTAHALA POWER AND LIGHT COMPANY; ALUMINUM COMPANY OF AMERICA; AND TAPOCO, INC.

No. 227A83

(Filed 3 July 1985)

1. Electricity § 3; Utilities Commission § 36— electric rates—affiliated utilities—treatment as integrated system—authority of Utilities Commission

The Utilities Commission has the authority, in the first instance, to determine for itself the relevant criteria to apply to the factual question of whether to treat Nantahala Power Company and Tapoco, Inc. as an integrated system for rate making purposes, and its determination will not be disturbed on appeal where supported by substantial evidence.

2. Electricity § 3; Utilities Commission § 15— Tapoco as public utility

The Utilities Commission correctly determined that Tapoco, Inc. is a public utility in North Carolina subject to its regulatory authority and jurisdiction.

3. Appeal and Error § 2— unanimous decision of Court of Appeals—scope of review

Pursuant to Rule 16(a) of the Rules of Appellate Procedure, the scope of review in the Supreme Court from an unanimous decision of the Court of Appeals is limited to consideration of the questions properly presented in the new briefs required by Rule 14(d)(1) and 15(g)(2) to be filed in the Supreme Court. Questions properly presented for review in the Court of Appeals but not presented and discussed in the new briefs to the Supreme Court are deemed abandoned under Rule 28(a).

4. Electricity § 3; Utilities Commission § 36— electric rates—roll-in methodology for Nantahala—no preemption by federal license

The Utilities Commission's order implementing a roll-in of the properties, revenues and expenses of Tapoco with those of Nantahala for the purpose of setting Nantahala's retail rates in no way contravened the terms and conditions of Tapoco's federal license to operate hydroelectric plants in North Carolina and Tennessee, and the Commission was not, therefore, preempted from implementing the roll-in by virtue of Part I of the Federal Power Act and the Supremacy Clause, Art. VI, cl. 2, of the U.S. Constitution.

5. Electricity § 3; Utilities Commission § 36— electric rates—affiliated utilities—treatment as integrated system—sufficient evidence

There was plenary evidence in the record to support a determination by the Utilities Commission that Nantahala and Tapoco constitute a single, integrated electric system and should be treated as such for the purposes of calculating Nantahala's retail rate base and costs of service.

6. Electricity § 3; Utilities Commission § 15— Alcoa as public utility

The evidence supported a determination by the Utilities Commission that Alcoa, the owner of all of the outstanding stock of Nantahala Power Company, is a North Carolina public utility under G.S. 62-3(23)c by virtue of the effect Alcoa's "affiliation" with Nantahala has had upon Nantahala's rates.

7. Electricity § 3; Utilities Commission § 36— electric rates—roll-in methodology for Nantahala—no preemption by Federal Power Act and Supremacy Clause

The Utilities Commission was not preempted from implementing a roll-in methodology for determining Nantahala's rates by virtue of the Supremacy Clause, Art. VI, cl. 2, of the U.S. Constitution and the Federal Energy Regulatory Commission's exclusive jurisdiction under Part II of the Federal Power Act over certain wholesale power transactions and agreements between and among Nantahala, Tapoco, Alcoa and TVA. The "filed rate" doctrine did not require the Utilities Commission, in determining the proper costs to Nantahala's retail customers for the service provided to them, to use demand and energy factors based upon the proportion of entitlements allocated to Nantahala alone under such agreements. Nor did the Utilities Commission's order conflict with specific FERC actions taken with respect to such agreements.

8. Electricity § 3; Utilities Commission § 21— jurisdiction over intrastate and interstate rates

The Federal Energy Regulatory Commission is prohibited from regulating intrastate retail rates charged to ultimate consumers, and the states are prohibited from regulating interstate wholesale rates charged to local distributing companies.

9. Electricity § 3; Utilities Commission § 21— wholesale intrastate electric rates—no authority by Utilities Commission

The N.C. Utilities Commission was preempted from directly or indirectly regulating the wholesale rate structure created by certain interstate power agreements between and among Nantahala, Tapoco, Alcoa and TVA or inquiring into the reasonableness of those FERC-filed wholesale rate schedules when it acted in fixing Nantahala's retail rates.

10. Utilities Commission § 38— electric rates—operating expenses considered

When the provisions of G.S. 62-133(b)(1), (b)(3) and (c) are read *in pari materia*, the only operating expenses which the Utilities Commission may consider in setting intrastate rates for North Carolina public utilities are those incurred in the provision of service to the utility's North Carolina consumers. Accordingly, jurisdiction cost allocation is a necessary step in any general rate case involving a public utility or utility system whose separate companies are operated as a single enterprise serving both jurisdictional (intrastate retail) and non-jurisdictional consumers.

11. Utilities Commission § 24— fixing "reasonable and just" rates—balancing of shareholder and consumer interests

The fixing of "reasonable and just" rates involves a balancing of shareholder and consumer interests. The Utilities Commission must therefore set rates which will protect both the right of the public utility to earn a fair rate of return for its shareholders and ensure its financial integrity while also protecting the right of the utility's intrastate customers to pay a retail rate which reasonably and fairly reflects the cost of service rendered on their behalf.

12. Utilities Commission § 38— operating expenses—questions of fact

The fundamental question as to whether certain expenditures are to be included in the operating expenses a utility is entitled to collect from its customers is one of fact to be ascertained by the regulatory authority.

13. Electricity § 3; Utilities Commission § 36— electric rates—power costs paid to affiliate

Ordinarily, the Utilities Commission may, in a proper case, refuse to allow a utility to include in its reasonable operating expenses the full price it actually paid for power as a result of its contractual power supply arrangements, especially where the operating expense is one incurred through a contract between or including the utility company and its affiliated companies. In such cases, the burden of persuasion on the issue of reasonableness always rests with the utility, and charges arising out of intercompany relationships between affiliated companies should be scrutinized with care and may be properly refused or disallowed in the absence of a showing of their reasonableness.

14. Electricity § 3; Utilities Commission § 36— electric rates—transactions with affiliated companies—filed rate doctrine

The Utilities Commission's otherwise plenary authority to investigate transactions between a public utility and its affiliated companies, and to disallow operating expenses found to be imprudently incurred or allocated under such agreements, is limited by prior federal approval of the rate or price in question under the "filed rate" doctrine. Thus, neither the state public service commission nor the courts can unilaterally establish a different rate for wholesale electric power sold in interstate commerce because they are of the opinion that an FERC-filed or approved rate is unfair or unreasonable.

15. Electricity § 3; Utilities Commission § 36— Nantahala's retail rates—interstate power supply arrangements—benefits to Alcoa—costs to be borne by Alcoa

Insofar as the Utilities Commission determined that Alcoa, as corporate parent and private industrial customer of Nantahala Power Company, had benefited at the expense of Nantahala's public load from interstate corporate and power supply arrangements it imposed upon its subsidiaries, it was within its regulatory authority to decide that the costs associated with those benefits would not be borne by Nantahala's public consumers in the form of higher retail rates but would be borne by Nantahala's customer and sole shareholder, Alcoa.

16. Electricity § 3; Utilities Commission § 36— electric rates—demand and energy factors—failure to use entitlements under interstate agreements—filed rate doctrine

The "filed rate" doctrine did not require the Utilities Commission, in determining the proper costs to Nantahala's retail customers for the service provided to them, to use demand and energy factors based upon the proportion of entitlements allocated to Nantahala alone under certain interstate wholesale power agreements between and among Nantahala, Tapoco, Alcoa and TVA.

17. Electricity § 3; Utilities Commission § 36— Alcoa's dominance of Nantahala—roll-in methodology—effect of FERC actions

The Federal Energy Regulatory Commission's analysis of the corporate structure of Alcoa, Nantahala and Tapoco and various intercorporate power transactions and agreements, and its finding that the evidence before it did not support the conclusion that Alcoa had used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act, did not preempt the N.C. Utilities Commission from determining that the evidence before it supported the conclusion that Alcoa had dominated Nantahala in such a manner as to require relief for Nantahala's retail customers under N.C. law. Nor did the Federal Energy Regulatory Commission's having declined to order a roll-in of Nantahala and Tapoco for rate making purposes preempt the Utilities Commission from implementing such a rate making methodology under its discretionary authority in setting intrastate retail rates.

18. Electricity § 3; Utilities Commission § 36— electric rates—roll-in methodology—no undue burden on interstate commerce

The Utilities Commission's adoption of a roll-in of the properties, revenues and expenses of Tapoco with those of Nantahala for the purpose of setting Nantahala's retail rates did not afford N.C. customers a "first call" on the energy output of the combined system and the economic benefits of Tapoco's lower-cost production so as to place an undue burden on interstate commerce in violation of the Commerce Clause, Art. I, § 8, cl. 3, of the U.S. Constitution.

19. Electricity § 3; Utilities Commission § 36— electric rates—roll-in methodology—no confiscation of Nantahala's properties

The Utilities Commission's implementation of a roll-in methodology for setting Nantahala's retail rates, with its resulting reduction in retail rates and refund obligation to Nantahala's retail customers, does not impermissibly impair Nantahala's ability to earn a proper rate of return on its investment and does not amount to a confiscation of its properties in violation of the due process clause of the Fourteenth Amendment to the U.S. Constitution and Art. I, § 19 of the N.C. Constitution.

20. Electricity § 3; Utilities Commission § 36— requiring refund to Nantahala's customers by Alcoa—authority of Utilities Commission

The Utilities Commission acted within its regulatory and rate making authority in imposing the obligation upon Nantahala's parent Alcoa to pay any portion of a refund obligation to Nantahala's retail customers which Nantahala is financially unable to pay. Once the Utilities Commission determined that

Alcoa was a statutory public utility under G.S. 62-3(23)c, it could rely upon the doctrine of "piercing the corporate veil" between Nantahala and its parent, Alcoa, to hold Alcoa financially responsible for Nantahala's refund obligation to the extent its affiliation had adversely affected Nantahala's rates as necessary or incident to the proper discharge of its regulatory duties under G.S. 62-30.

21. Electricity § 3; Utilities Commission § 36— electric rates—piercing the corporate veil—fraud not required

The Utilities Commission was not required to find fraud in order to pierce the corporate veil between Nantahala and its parent, Alcoa.

22. Electricity § 3; Utilities Commission § 36— Nantahala's retail rates—piercing the corporate veil—effect of prior actions by regulatory agencies

Prior investigation and regulation of the activities of Alcoa and Nantahala by state and federal regulatory agencies did not prohibit or preempt the N.C. Utilities Commission from piercing the corporate veil between Alcoa and its wholly-owned subsidiary Nantahala to hold Alcoa financially responsible for Nantahala's refund obligation to its retail customers.

23. Electricity § 3; Utilities Commission § 36— refund to Nantahala's customers—responsibility of Alcoa

There was no merit to Alcoa's contention that it could not be required to pay refunds based upon Nantahala's overcollections prior to 30 October 1980, the date on which the Utilities Commission found Alcoa to be a public utility.

24. Electricity § 3; Utilities Commission § 36— refund to Nantahala's customers—responsibility of Alcoa—no confiscation of Alcoa's property

The Utilities Commission's imposition of an obligation upon Alcoa to pay any portion of a refund obligation to Nantahala's retail customers which Nantahala is financially unable to pay does not amount to a confiscation of Alcoa's property.

25. Electricity § 3; Utilities Commission § 21— period of refund of excessive rates—no retroactive rate making

When, upon appellate review and further action by the Utilities Commission, rates approved for Nantahala by the Utilities Commission in 1977 were determined to be excessive, the Utilities Commission properly ordered Nantahala to refund all excessive rates collected since the 1977 order, not just overcollections which were subject to an undertaking for refund after 6 March 1979 when the Court of Appeals vacated the 1977 order. Furthermore, the Commission's refund order did not amount to retroactive rate making since the rates ultimately fixed and the refund were not collectible for past service but for service in the locked-in docket period.

26. Electricity § 3; Utilities Commission § 21— amount of refund to utility's customers

The Utilities Commission properly ordered Nantahala to refund excess revenue measured by rates determined by a roll-in methodology in this proceeding rather than by what would have been collected under Nantahala's prior rate schedule.

27. Electricity § 3; Utilities Commission § 56— electric rates—order based on independent findings

In this rate case in which the Utilities Commission implemented a roll-in methodology for determining Nantahala's rates and held Nantahala's parent corporation Alcoa financially responsible for refunds to Nantahala's customers, all parties received a full and fair hearing at all stages of the original and remanded proceedings, and the Commission's order was, in all respects, based upon fully independent and well substantiated findings of fact and conclusions of law and not on observations made by the N.C. Supreme Court in remanding the proceeding to the Commission.

Justice VAUGHN did not participate in the consideration or decision of this case.

APPEAL by respondents pursuant to N.C.G.S. § 7A-30(3) from the decision of the Court of Appeals, reported at 65 N.C. App. 198, 309 S.E. 2d 473 (1983), affirming the order of the North Carolina Utilities Commission entered 2 September 1981, Docket No. E-13, Sub 29 (Remanded) reducing retail electric utility rates and requiring a refund by respondents Nantahala Power and Light Company ("Nantahala") and its parent corporation, Aluminum Company of America ("Alcoa") to Nantahala's retail ratepayers for the four-year period of 1977-1981. Heard in the Supreme Court 12 April 1984.

This matter was initiated by Nantahala on 3 November 1976 by the filing of an application with the North Carolina Utilities Commission ("Commission") by Nantahala to establish new rates so as to increase its charges to North Carolina retail customers by $1,830,791. The Commission declared the matter to be a general rate case pursuant to N.C.G.S. § 62-137 and ordered an investigation and hearing. Various parties representing the interests of Nantahala's retail ratepayers intervened and moved that Alcoa and its wholly-owned subsidiary, Tapoco, Inc. ("Tapoco") be joined as parties and that the rate base of Nantahala be computed on a "rolled-in" basis to include the properties, revenues and expenses of Tapoco, as if the two were operating as one utility for the purpose of fixing and establishing a reasonable level of retail rates for Nantahala. These motions were disallowed by the Commission.

On 14 June 1977 the Commission issued an order in Docket No. E-13, Sub 29, permitting Nantahala to put into effect revised rates so as to produce $1,598,918 in additional gross revenues.

The order was not stayed and Nantahala implemented the approved rates at that time. The Court of Appeals reversed, held Tapoco to be a North Carolina public utility, vacated the order authorizing the rate increase and remanded the case to the Commission for the purpose of making Tapoco a party and considering "whether the people of North Carolina would benefit by the use of the roll-in method of rate making involving Nantahala and Tapoco." *Utilities Comm. v. Edmisten, Attorney General*, 40 N.C. App. 109, 120, 252 S.E. 2d 516, 522 (1979).

Nantahala sought and obtained from this Court a stay of the Court of Appeals' decision pending further review. Upon Nantahala's appeal from the Court of Appeals, this Court affirmed in part, reversed in part, and remanded the matter to the Commission for further hearings. *Utilities Comm. v. Edmisten, Attorney General*, 299 N.C. 432, 263 S.E. 2d 583 (1980) ("*Edmisten*").

In *Edmisten* we assumed, without deciding, that Tapoco was a North Carolina public utility subject to the regulatory authority of the Commission, found that there was ample evidence to support a finding that Nantahala and Tapoco operate as a single unified public utility system, held that the Commission erred in giving only minimal consideration to the evidence suggesting the propriety of roll-in, and indicated that the roll-in device or methodology for rate making computation "seems especially appropriate in a case such as this where one physically integrated system, interconnected in such a way that all power available to the system can be used to enhance its overall reliability and supply its requirements as a whole, is presided over by two corporate entities." 299 N.C. at 442, 263 S.E. 2d at 591. In addition, this Court held that Alcoa and Tapoco could be brought in as parties, with a *de novo* right to contest the Commission's jurisdiction; permitted the increased rates to remain in effect, conditioned upon Nantahala's guarantee that it would refund to its customers any excess charges, should the increased rates originally approved by the Commission ultimately be determined to be excessive; and remanded the matter to the Commission with directions to "obtain and consider information and data showing what Nantahala's cost of service to its customers would be if this [roll-in] method of rate making were used and whether Nantahala's customers would benefit thereby." 299 N.C. at 443, 263 S.E. 2d at 591. Thereafter, Nantahala executed an Undertaking to Refund, agreeing to re-

fund any overcollections to its customers should the rates approved by the order of 14 June 1977 be determined excessive.

Upon remand to the Commission and after *de novo* proceedings, Alcoa and Tapoco were held to be North Carolina public utilities and both were made parties respondent to the proceeding. Prior to the remanded rate hearings, the intervenors moved that Alcoa and Tapoco be required to join the execution of Nantahala's undertaking, or, in the alternative, to guarantee Nantahala's ability to make the refund. The Commission deferred its ruling on this motion until a later date.

The case was heard before a panel of the Commission during the months of March, April and May of 1981, and both the intervenors and the respondents presented evidence concerning the propriety of a roll-in, for accounting purposes, of Nantahala's and Tapoco's accounting data in setting Nantahala's retail rates. The panel determined that Nantahala's retail customers would benefit by a roll-in methodology treating Nantahala and Tapoco as a unified system and adopted the roll-in cost allocation formula proposed by the intervenors. On 2 September 1981 the panel ordered a reduction in Nantahala's rates from the level previously approved by the Commission's order of 14 June 1977, in the amount of $2,035,000 annually and, in addition, modified certain purchased power adjustment costs. The panel, consistent with the rate reduction, also ordered Nantahala to refund the excess rates it had been collecting under the 1977 order from its retail customers and directed that Alcoa would be responsible for refunding such portions of the total refund obligation as Nantahala itself is financially unable to refund.

The respondent companies appealed to the Full Commission. After additional hearings, the Commission affirmed and adopted the panel's order in all respects on 28 January 1982. On 16 August 1982, the Commission, after requesting and rejecting several refund plans submitted by Nantahala and Alcoa, ordered the two companies to commence making refunds by monthly installments in October 1982. The Commission left it to the companies to determine the proportion of the refund obligation each would pay, with the provision that any division of financial responsibility not affect Nantahala's ability to continue service to its customers.

The Commission's order was stayed pending appeal to the Court of Appeals. Thereafter, all relevant orders of the Commission were affirmed by the Court of Appeals in *State ex rel. Utilities Comm. v. Nantahala Power & Light Co.*, 65 N.C. App. 198, 309 S.E. 2d 473 (1983). The respondents appeal pursuant to former N.C.G.S. § 7A-30(3), which permitted an appeal of right of any general rate case from the Court of Appeals to this Court in cases decided prior to 1 July 1983. *See* 1983 N.C. Session Laws, Ch. 526, Sec. 10.

Hunton & Williams, by Robert C. Howison, Jr., and Edward S. Finley, Jr., Attorneys for defendant-appellant Nantahala Power and Light Company.

LeBoeuf, Lamb, Leiby & MacRae, by Ronald D. Jones and David R. Poe, Attorneys for respondent-appellants Aluminum Company of America and Tapoco, Inc.

Rufus L. Edmisten, Attorney General, by Richard L. Griffin, Assistant Attorney General, Attorney for Using and Consuming Public.

Robert Gruber, Executive Director, by James D. Little, Staff Attorney, The Public Staff, Attorneys for Using and Consuming Public.

Crisp, Davis, Schwentker & Page, by William T. Crisp and Robert W. Schwentker, Attorneys for Henry J. Truett; Counties of Cherokee, Graham, Swain, Jackson; Towns of Andrews, Dillsboro, Robbinsville, Bryson City, Sylva; and the Tribal Council of the Eastern Band of the Cherokee Indians.

Joseph A. Pachnowski, Attorney for the County of Swain and the Town of Bryson City.

Western North Carolina Legal Services, by Larry Nestler, Attorney for Derol Crisp.

McKeever, Edwards, Davis & Hays, by Fred H. Moody, Jr., Attorney for County of Swain.

Charles L. Lewis, Assistant Attorney General, Attorney for State of Tennessee and Tennessee Department of Economic and Community Development, Amici Curiae.

Mayer & Magie, by Roderic G. Magie, and Spiegel & McDiarmid, by James N. Horwood, Cynthia S. Bogorad, and P. Daniel Bruner, Attorneys for the Town of Highlands, Amicus Curiae.

MEYER, Justice.

TABLE OF CONTENTS

d. Refund Required

1. Temporal Extent

2. Confiscation

3. Nantahala's Non-Constitutional Challenges

a. Temporal Extent of Refund Obligation

b. Measure of Refund Obligation

D. Independent Findings of the Commission

III

Conclusion and Holding

This appeal raises substantial questions under the federal constitution and the North Carolina statutory provisions governing intrastate electric power rates charged by a public utility to its retail customers. The most important question presented is whether the North Carolina Utilities Commission is preempted from implementing a roll-in methodology for setting Nantahala's retail rates by virtue of the Supremacy Clause of the United States Constitution, art. VI, cl. 2 and the Federal Energy Regulatory Commission's ("FERC") exclusive jurisdiction over certain interstate wholesale power transactions and agreements[1] between and among, Nantahala, Tapoco, Alcoa and the Tennessee Valley Authority ("TVA"). For the reasons set forth more fully below, we find no statutory or constitutional infirmity in the order of the North Carolina Utilities Commission issued in Docket No. E-13, Sub 29 (Remanded), and therefore affirm the decision of the Court of Appeals upholding the retail rate reduction and refund obligation to Nantahala's public utility customers.

In Part I of this opinion we will undertake to review (a) the procedural history of this case, (b) the historical development of Nantahala and Tapoco as a single, unified hydroelectric generating and distribution system, (c) the factual predicate to the Commission's decision to implement a roll-in rate making methodology, and (d) the mechanics of the roll-in in the allocation of costs for the unified system. In the course of this review, we shall address such factual and legal issues raised by the companies as are relevant to the Commission action under discussion. In Part II, we will address the major constitutional and statutory challenges to the Commission's order lodged by the respondent companies. Briefly stated, these challenges concern (a) federal preemption; (b) interference with interstate commerce; (c) the measure, extent and liability for the rate reduction and refund obligation; and (d) the independence of the factual findings of the Commission.

1. Part II of the Federal Power Act, 16 U.S.C. §§ 824-824k extends federal regulatory power to the transmission and sale of electric energy at wholesale in interstate commerce, while reserving to the various states the authority to regulate intrastate transmission and sale of electric energy at retail.

I.

A.

This appeal represents the culmination of a process begun in 1976, with Nantahala's application for permission to increase its retail rates and a revision of its purchased power adjustment clause (PPAC) applicable to those rates. The initial order entered by the Commission on 14 June 1977 in Docket No. E-13, Sub 29, approving certain annual increases in Nantahala's rates and a PPAC adjustment was ultimately reversed on appeal by this Court in *Edmisten*, 299 N.C. 432, 263 S.E. 2d 583. The basis for reversal was the Commission's failure as a matter of law to give more than minimal consideration to material facts of record concerning the propriety of treating Nantahala and its affiliate Tapoco, both wholly owned subsidiaries of Alcoa, as a single unified electric utility and rolling together their properties and costs for purposes of determining just and reasonable retail electric rates for Nantahala's North Carolina customers. 299 N.C. at 437, 263 S.E. 2d at 587-88. The case was remanded with directions to the Commission to obtain and consider information and data showing what Nantahala's cost of service to its customers would be if the roll-in method of rate making were used and whether Nantahala's customers would benefit thereby. *Id.* at 443, 263 S.E. 2d at 591.

Upon remand, the Commission, in preliminary hearing, determined that it had jurisdiction over Nantahala's parent corporation, Alcoa and its affiliate, Tapoco, and joined them as parties in Docket No. E-13, Sub 29 (Remanded). A panel of the Full Commission then held hearings and received evidence from both the intervening customers of Nantahala and from the respondent com-

panies on the question of roll-in. In addition to the evidence received during Nantahala's initial rate increase hearings in 1977 regarding Nantahala's costs and the relevant test year (1975) data, both parties presented additional testimony and data concerning Nantahala's rolled-in costs of service to its retail customers. The companies presented one allocation methodology for apportioning the combined revenues, expenses and investment of the rolled-in system between the system's North Carolina retail operations and non-jurisdictional Tennessee industrial operations, and the intervenors presented another.

Briefly stated, the basic dispute between the intervenors and the companies as to *which* jurisdictional cost allocation methodology to use involves the question of whether the rolled-in power costs are to be allocated to Nantahala's retail customers on the basis of its actual contribution and use of hydroelectric generation and capacity in the unified system or upon the proportion of return power entitlements it receives under the wholesale agreements between and among the companies themselves and the Tennessee Valley Authority ("TVA"). The intervenors contend that the former allocation formula is just and appropriate for setting Nantahala's retail rates. The companies maintain that the latter is mandated under the federal and state division of, respectively, wholesale and retail rate making authority, because the contracts at issue are federally filed and approved wholesale rates which must be given effect by state public service commissions in setting retail rates.

The wholesale power coordination and exchange agreements primarily at issue are (1) the New Fontana Agreement ("NFA"), a 1962 power exchange agreement among the three companies and TVA, whereby Nantahala and Tapoco subject all of their large plant electrical generation to TVA control and turn over that generation directly to TVA, in exchange for annual return power entitlements for the two subsidiaries to divide amongst themselves; and (2) the 1971 Nantahala-Tapoco Apportionment Agreement, a contract between the two subsidiaries, whereby the demand and energy return power entitlements received under the NFA are divided between them, with Nantahala receiving no more than a fixed amount of power and energy, and Tapoco receiving the remainder.[2] These, and other contractual arrangements affecting Nantahala's costs of service will be discussed more fully below.

The Commission, in view of the evidence presented by all the parties upon remand, found and concluded that (1) Nantahala and Tapoco are North Carolina public utilities subject to its rate making jurisdiction; (2) Alcoa, by virtue of its parental domination of Nantahala, was itself a statutory North Carolina public utility pursuant to N.C.G.S. § 62-3(23)c; (3) the Nantahala-Tapoco electric generation and distribution system constitutes a single, integrated electric system, operated as such and coordinated with the TVA system; (4) use of an appropriately performed roll-in of Nantahala and Tapoco would be beneficial to Nantahala's customers because its allocated cost of power under the combined system is less than the cost of power for Nantahala as a standalone system, such that a roll-in will result in a significant reduction in the cost of providing public utility electric service to the single system's retail customers; (5) significant detriments and inequities to Nantahala arise out of both the NFA and the 1971 Apportionment Agreement, which result in concealed benefits flowing to Alcoa through its subsidiary Tapoco, and render use of the companies' cost allocation formula based on the demand and energy entitlements under those contracts inappropriate for determining the costs fairly attributable to the North Carolina public load in the combined system; (6) the cost allocation methods and procedures proposed by the intervenors, based upon the generational capabilities and needs of Nantahala, are proper for use in the allocation of its demand and energy related costs and should be adopted for use in setting Nantahala's retail rates in the subject proceeding; and (7) Alcoa had so dominated Nantahala in certain contracts and transactions involving Nantahala, Tapoco and others that Nantahala had been left "but an empty shell,

2. In practice, the NFA and its predecessor, the original Fontana Agreement ("OFA"), operated as "sales" to TVA of electric power for resale under Part II of the Federal Power Act, 16 U.S.C. §§ 824-824k, by Alcoa's subsidiary-public utilities (Nantahala and Tapoco), with TVA making payments in kind to the Alcoa "system" as a whole. In turn, TVA's "payments" of return power have been divided amongst the system members as they themselves have designated. The various agreements are, accordingly, treated as tariffs or rate schedules by FERC and are subject to regulation under Part II of the Act to assure that the terms and conditions are just and reasonable and not unduly discriminatory, despite the fact that no dollars actually change hands as rate payments.

unable to act in its own self-interest, let alone in the interest of its public utility customers in North Carolina," so as to render Alcoa responsible for such portions of any refund obligation placed upon Nantahala as Nantahala itself is unable to make.

The Commission adopted the intervenors' roll-in methodology, which resulted in lowered rates and required refund obligation to be placed upon Nantahala and Alcoa. Essentially, the roll-in method adopted treats Nantahala and Tapoco as a single integrated system for accounting purposes. That is, (a) the assets, properties, plants and working capital requirements of the two companies were joined in one unified rate base; (b) the joint revenues and expenses of the single system were totalled; and (c) the combined system was assigned the rate of return previously approved by the Commission for Nantahala alone in the Sub 29 proceeding. From these three elements, the combined system revenue requirement (expenses + rate base × rate of return) was derived.

The combined system cost of service was then allocated between the public load customers in North Carolina and the industrial load customer (Alcoa) in Tennessee, using generally accepted jurisdictional allocation factors commonly employed by the Commission in setting North Carolina retail rates for other companies, such as Duke Power or Carolina Power & Light, which operate in more than one state. Rates for Nantahala's public load customers could be reduced because the cost of service per kwh for the combined Nantahala-Tapoco system is less than for Nantahala treated as a stand-alone electric system.

In its final order entered 28 January 1982, the Commission overruled the exceptions taken by the companies to the panel's order implementing roll-in and made supplementary conclusions of law on certain "federal questions" arising by virtue of the panel's rejection of the companies' proposed jurisdictional cost allocation methodology. The Commission rejected, inter alia, the companies' arguments (1) that the panel's order is precluded by exclusive federal licensing of interstate hydroelectric power facilities under Part I of the Federal Power Act, 16 U.S.C. §§ 791a-823a; (2) that the order intrudes upon the authority vested in FERC by Part II of the Federal Power Act, 16 U.S.C. §§ 824-824k, by failing to accept the costs of filed rates under the

NFA and the 1971 Apportionment Agreement; and (3) that the order imposes an impermissible burden on interstate commerce.

The companies, in their individual briefs, challenge the Commission's order on a number of state and federal grounds. Tapoco's sole contention relates to its "involuntary joinder" as a party on the grounds that the Commission is without statutory authority to affect Tapoco's rates and service to its Tennessee customer, Alcoa, and is preempted from doing so by virtue of the fact that Tapoco's four hydroelectric plants are licensed by, and under the exclusive regulatory jurisdiction of, FERC under Part I of the Federal Power Act, 16 U.S.C. §§ 791a-823a. Nantahala's and Alcoa's objections may be broken down into four categories: (1) challenges to the order implementing the roll-in arising under the Supremacy Clause of the United States Constitution, art. VI, cl. 2 and Part II of the Federal Power Act, 16 U.S.C. §§ 824-824k; (2) claims that the order contravenes the Commerce Clause of the United States Constitution, art. I, sec. 8, cl. 3, by placing an impermissible burden on interstate commerce; (3) challenges to the constitutionality, measure and extent of the rate reduction and refund obligation as well as to the Commission's jurisdiction to hold Alcoa liable for its subsidiary's refund obligation; and (4) challenges to the order issued on remand based upon the alleged failure of the Commission to make independent findings of fact as to the propriety of the roll-in methodology for determining Nantahala's rates and its jurisdiction over Nantahala's parent Alcoa.

In our earlier decision reversing the Commission's 1977 approval of the rate increase requested by Nantahala in Docket No. E-13, Sub 29, we briefly reviewed the history of the three companies and the basic contracts affecting Nantahala's costs of service. *Edmisten*, 299 N.C. at 434-39, 263 S.E. 2d at 586-89. That review was undertaken with an eye toward (1) elucidating the material facts of record accorded only minimal consideration by the Commission in assessing the factors bearing upon the determination of reasonable retail rates for Nantahala and (2) delineating the legal significance of evidence indicating that Nantahala had structured its economic affairs and physical operations so as to afford an unfair preference to its parent corporation to the detriment of its North Carolina public utility customers. *Id.* The complex factual predicate of the Commission's order implementing roll-in and the rather intricate corporate and contractual rela-

tionships between and among the companies and TVA renders a more extended treatment of the subject necessary in order to place the issues raised by the parties to the present appeal in their proper perspective.[3]

B.

As we noted in *Edmisten*, the factual background of the case is not generally disputed by the parties. In the early part of the century, Alcoa came to the sparsely populated southwestern North Carolina mountains to tap the resources of the mountain streams for low-cost electric power to operate an aluminum reduction plant in neighboring Alcoa, Tennessee. As its source of hydroelectric power, Alcoa acquired the Tallassee Power Company ("Tallassee") (later Carolina Aluminum Company and now Yadkin, Inc.), an electric generating company incorporated in North Carolina and granted the power of eminent domain by legislative act in 1905.[4] Tallassee owned several undeveloped and developed hydroelectric sites along the Little Tennessee River in North Carolina, including two hydroelectric generating facilities at Santeetlah and Cheoah. Tallassee, under the name Carolina Aluminum, was recognized as a North Carolina public utility as early as 1934 in *Manufacturing Co. v. Aluminum Co.*, 207 N.C. 52, 175 S.E. 698 (1934).

By the 1920's, Alcoa, through its subsidiaries, had acquired a substantial number of hydroelectric sites along the Little Tennessee River: Santeetlah, Cheoah, Nantahala, Glenville (now Thorpe), Needmore, Fontana and several smaller sites in North Carolina and Chilhowee and Calderwood in Tennessee. Development of the sites was primarily for the purpose of producing and transmitting electricity to the Alcoa, Tennessee aluminum reduction plant, which requires enormous amounts of low-cost electricity.

3. For the purposes of this historical review, we have relied upon the entire record before the Commission in the Sub 29 (Remanded) proceeding. In addition, in an effort to present a complete picture of the regulatory history of the companies involved, we have, where necessary, taken judicial notice of various prior opinions of this Court, as well as certain prior decisions and orders of the Federal Power Commission and its successor, the Federal Energy Regulatory Commission.

4. *See* Chapter 122 of the private laws enacted by the General Assembly of North Carolina at its regular session in the year 1905.

In 1929 Alcoa created and incorporated Nantahala as another of its wholly owned subsidiaries in North Carolina. Nantahala is a North Carolina public utility with the right of eminent domain, serving a six county franchised territory in the western part of the State. Nantahala's customer mix consists of residential, commercial, industrial and wholesale customers. In time, Tallassee sold its undeveloped North Carolina sites to Nantahala, including the Fontana site later developed by TVA. By 1939, Nantahala owned sites for power development in six western counties of North Carolina.

Between 1929 and 1941, Nantahala undertook token public service through several small, run-of-the-river hydroelectric generating plants acquired from municipalities in its service area and completed acquisition of several sites from Tallassee. In 1941 Nantahala obtained a certificate from the Department of War to develop the large-scale Nantahala and Glenville (now Thorpe) projects on the upper reaches of the Little Tennessee watershed. Nantahala's stated justification for the development of these sizeable projects was the huge electric need of Alcoa's aluminum smelting works in Tennessee, which were then producing aluminum to sell to the federal government for war materials. In its application, Nantahala repeatedly referred to the developments as part of "the Alcoa power system" or "the system."

Prior to 1941, both Nantahala and TVA were interested in developing the massive Fontana site on the Little Tennessee River in North Carolina. Nantahala proposed to construct a large hydroelectric project with storage capacity. The proposed project, known as the Fontana project, was to generate electricity both for aluminum production and for use by the public. Following a determination by FERC's predecessor, the Federal Power Commission ("FPC") that a license was required from that agency under Part I of the Federal Power Act before Nantahala could construct, thereby subjecting the proposed project and Nantahala to a limited-term license under Section 6 of the Act and to the agency's ongoing jurisdiction, Nantahala abandoned its proposal. *See Nantahala Power and Light Co.*, 2 F.P.C. 833 (1940), *petition for discontinuance denied*, 2 F.P.C. 388 (1941).[5] TVA, which had al-

5. Nantahala, upon learning that the project would not be exempt under federal law and that at most, the FPC would grant a 50-year license permitting

ready obtained some acreage in the reservoir site, eventually prevailed upon Alcoa to have the Fontana site transferred to TVA for development. At that time, Alcoa was already purchasing some of the power requirements for its Tennessee aluminum production facilities from TVA. The conveyance was part of the first power coordination and exchange agreement of relevance between Alcoa and TVA, entered into in 1941, which had become known over the years as the Original Fontana Agreement ("OFA").

The 1941 Agreement is a twenty-year (but annually renewable thereafter) contract between Alcoa and TVA, pursuant to which Alcoa agreed to cause Nantahala (not a party to the agree-

recapture, withdrew its declaration of intention. As to the companies' regard for the public's interests in this project, the Federal Power Commission stated:

> Notwithstanding the public interest, Alcoa, through its subsidiary, in effect demonstrated that in its national defense effort it was unwilling to accept the reasonable limitations on unearned increment in the value of its power project provided by Congress in the Federal Power Act.
>
> *The Fontana situation is not the only instance in which Alcoa and its subsidiaries have shown complete unwillingness to accept provisions of Federal law, regardless of the consequences to the national defense or to the public which they serve. . . .*
>
> Neither the Federal Power Act nor the licenses issued thereunder contain provisions onerous to the operation of a project utilizing the waters of streams subject to Federal control. The provisions of the Act and the license are, in fact, designed wholly to protect the public interest in the use of waters which belong to the Nation. Many other persons and corporations, both public utilities and industrial concerns, have sought and accepted licenses. *The refusal of Alcoa's subsidiary to construct the Fontana project, when required to obtain a license, indicates that not even the urgent demands of national defense can alter its apparent determination never willingly to submit any of its hydro projects to the duly enacted requirements of Federal law. . . .*
>
> Their attempted withdrawal is inconsistent with their contention regarding their interest in national defense and with their planned 25-year program of construction.
>
> *In our opinion Alcoa and the company have not dealt frankly in this matter, but have in the past undertaken and are now attempting to evade the plain provisions of the law.* (Emphasis added.)

Nantahala Power and Light Company, 2 F.P.C. 388, 390-91 (1941). An incidental effect of the subsequent conveyance to TVA of the Fontana site was the removal or elimination of the FPC's licensing authority over the Fontana project. *See* 16 U.S.C. § 831y-1. However, as is evident from the various agreements, the conveyance did not sever Alcoa's link with the project.

ment) to transfer the Fontana Dam site to TVA. The property so transferred was valued at approximately $3.5 million.[6] The transfer was effectuated by Alcoa's repurchase of the Fontana site from Nantahala for $1.9 million, or approximately $128 per acre. Nantahala had purchased the property from Tallassee at a cost of $112 per acre in 1929.

Under the terms of the OFA, the Fontana project, when completed by TVA, was to be operated together with other TVA generating plants owned by Alcoa's subsidiaries. The agreement refers to Alcoa as the "Company," and the "Company's plants" as including Nantahala's generating plants as well as the other plants now owned by Tapoco. The agreement called for the Alcoa system companies to convey the output from their generating plants to TVA in return for power and energy entitlements. The level and amount of power entitlements were dependent upon the level of generation which TVA controlled. In exchange for the companies' relinquishment of their control over stream flow and production from their plants (then operating or under construction) at Santeetlah, Cheoah, Calderwood, Nantahala and Glenville (Thorpe), TVA provided compensation power of 11,000 kw to the Alcoa system. Alcoa purchased Nantahala's portion of this compensation power for an annual payment of $89,200.

Although the OFA did not itself specify how the entitlements returned to the Alcoa system by TVA were to be divided among the system's member companies, the companies apparently would receive back as much or as little capacity and energy as each generated proportionately through its individually owned projects. In October 1954 Nantahala and Alcoa entered into a contract which called for Nantahala, when it had excess power, to make the excess available for Alcoa's use at its Tennessee facilities, and conversely, called for Alcoa to provide the power for Nantahala to meet its public load when Nantahala alone could not meet its public service obligation. *See Tapoco, Inc., Initial Decision*, 30 F.E.R.C. ¶ 63,050, at p. 65,273-74 (1985). Throughout the period of these contracts, Nantahala's capacity and energy production were far in excess of the demands of its then existing public service load. Nantahala's excess entitlements under OFA were then sold to Alcoa at "dump" prices. *See Utilities Commission v. Member-*

6. *Edmisten*, 299 N.C. at 435, 263 S.E. 2d at 586.

ship Corp., 260 N.C. 59, 131 S.E. 2d 865 (1963). There is no indication that the 1954 Alcoa-Nantahala contract was ever filed with the FPC as a tariff or rate schedule under Part II of the Federal Power Act. *See* 30 F.E.R.C. ¶ 63,050 at p. 65,275.

Moreover, when the OFA was signed in 1941, none of the Alcoa system plants subject to it had a license from the FPC under Part I of the Federal Power Act. The agreement itself was never filed with the FPC as a tariff or rate schedule during the twenty years that it remained in effect. As a consequence, the FPC never ruled upon the lawfulness or the agreement as a rate schedule while it was in effect. 30 F.E.R.C. ¶ 63,050 at p. 65,274.

In fact, it would appear from the contemporaneous decisions of the FPC that the federal agency only considered the operative terms of the OFA in an effort to determine whether it had licensing jurisdiction over three of the Alcoa system plants[7] which were subject to it—Calderwood, Santeetlah and Cheoah. At the time of the OFA's execution, Calderwood was owned by Alcoa subsidiary, the Knoxville Power Company (later Tapoco), and Santeetlah and Cheoah were owned by Alcoa subsidiary, the Carolina Aluminum Company. In 1941, the FPC instituted proceedings directing Alcoa and its subsidiaries to show cause why they should not be required to apply for licenses under Part I of the Federal Power Act for the continued operation and maintenance of the three plants. *In re Aluminum Co. of America*, 13 F.P.C. 14 (1954). Ultimate resolution of the matter was delayed by the pressures of the war emergency until March 1954. By that time, the respondent companies argued that the three plants were exempt from FPC jurisdiction because they were operated by TVA under the OFA.

The only actual discussion of the OFA comes in the FPC's discussion and rejection of the companies' arguments *in avoidance* of the agency's jurisdiction.

> *The Projects are Operated by Respondents.*—Under date of August 14, 1941, Alcoa and TVA entered into an agreement

7. All references in the opinion to "the Alcoa system" or the "Alcoa power system" or like phrases, refer exclusively to the subsidiary *operating* utilities which provide or provided the generation and transmission of electricity to their parent company Alcoa.

> (the Fontana Agreement) by the terms of which Alcoa transferred to the United States its interest, and those of its wholly-owned subsidiary, in the lands from the then proposed Fontana project and agreed upon a plan for "the coordinated operation of power facilities" of the Alcoa system and the TVA system. . . .
>
> The Fontana Agreement provides for the coordinated operation of power facilities of the two systems under the direction of TVA. Respondents contend that under this arrangement TVA "operates" the Calderwood, Cheoah, and Santeetlah projects within the meaning of the exemption provision of the last paragraph of Section 26(a) of the TVA Act (16 U.S.C. 831-Y-1). (Footnotes omitted.)

13 FPC at 21. The FPC went on to reject the exemption arguments advanced by Alcoa and its subsidiaries, finding that the Fontana Agreement "does not undertake to place the operation of Respondents' projects in TVA," but merely coordinates such operations as the companies themselves actually perform with the power facilities in the TVA system, "for the mutual benefit of Alcoa and TVA." *Id.* at 22. Consequently, the operating companies were ordered to file license applications under the Federal Power Act for the continued operation and maintenance of the three plants. *Id.* at 32. Thus, the OFA was not presented to the FPC by Alcoa and its subsidiaries for the purpose of affirmative regulation, but as part of an effort to preclude such federal oversight over the system's plants and power transactions.

During the period of the OFA's duration, a number of significant events occurred within the Alcoa system. As we have seen, in March 1954, thirteen years after the signing of the OFA, the FPC rejected the arguments of the Alcoa system and ruled that Cheoah and Santeetlah, among other plants subject to the OFA, required a license under the Federal Power Act. *In re Aluminum Company of America*, 13 F.P.C. 14.[8] In October of that year (1954),

8. Nantahala's hydroelectric generating plants subject to the various Fontana agreements were not required by the FPC to be licensed by that agency until the mid-1960's. *See Nantahala Power and Light Co.*, 36 F.P.C. 119 (1966), *rehearing denied*, 36 F.P.C. 581 (1966), *aff'd on review*, *Nantahala Power and Light Co. v. FPC*, 384 F. 2d 200 (4th Cir. 1967), *cert. denied*, 390 U.S. 945, 19 L.Ed. 2d 1134 (1968).

the wholly-owned subsidiary of Alcoa which was originally incorporated in Tennessee as the Knoxville Power Company, underwent a change of name to Tapoco, Inc. Within two weeks of its name change, Tapoco was domesticated as a North Carolina corporation.

As of October 1954, Tapoco owned two hydroelectric sites along the Little Tennessee River at Calderwood and Chilhowee in Tennessee. Tapoco, as well as acting as the power supplier to Alcoa's Tennessee aluminum smelting and fabricating facility, had at that time a public service load in Tennessee.

Another noteworthy event of October 1954 was the filing of a joint application by Tapoco and its affiliate, Carolina Aluminum Company to the FPC for a license to operate the "Tallassee project" along the Little Tennessee River in North Carolina and Tennessee. The project entailed the continued operation of the Cheoah and Santeetlah plants in North Carolina, and another existing plant in Tennessee at Calderwood (also subject to the OFA) and the construction of another hydroelectric generation plant at Chilhowee, Tennessee. The FPC's licensing order of March 1955 indicates that in their joint application, the companies stated that the energy from the Tallassee project, "is and will continue to be delivered to the Tennessee Valley Authority, which in turn delivers an equivalent amount of energy to the Aluminum Company of America at Alcoa, Tennessee, pursuant to the provisions of the Fontana agreement and the supplemental agreement thereto, dated August 14, 1941 and October 13, 1954, respectively." *Tapoco, Inc. and Carolina Aluminum Co.*, 14 FPC 610, 612 (1955). The licensing order continued by noting that the joint application states that after the exchange of energy between TVA and the Alcoa system pursuant to the Fontana agreement, "*[a]ll* the energy is used for aluminum production *except for* a small portion used for lighting in operators' villages." *Id.* at 612-13. (Emphasis added.) By June 1955, Tapoco had become the sole licensee of the four plants. *See Carolina Aluminum Co. and Tapoco, Inc.*, 14 F.P.C. 828 (1955); *Carolina Aluminum Co., Tapoco, Inc. & Nantahala Power and Light Co.*, 14 F.P.C. 829 (1955). Thereafter, Carolina Aluminum changed its name to its present name of Yadkin, Inc. The company now operates only the hydro facilities, not at issue here, which serve Alcoa's North Carolina, Badin works.

Conspicuous in its absence from the 1955 licensing order is any reference to the fact that TVA return power entitlements were also used to service Tapoco's public utility load in Tennessee and Nantahala's public utility load which, by the early 1950's, had increased to 10,000 customers, both residential and industrial, in a six-county area in North Carolina. *See Utilities Commission v. Mead Corp.*, 238 N.C. 451, 78 S.E. 2d 290 (1953). In addition, the licensing order fails to refer to the FPC's own earlier recognition that under the Fontana exchange and coordination agreements with TVA, Nantahala's larger plants were being operated together with Tapoco's plants as part of what the FPC termed " 'the coordinated operation of power facilities' of the Alcoa system and the TVA system." *In re Aluminum Company of America*, 13 F.P.C. at 21.

At about the same time that the federal license application was under consideration, Tapoco, Carolina Aluminum Company and Nantahala jointly filed for a certificate of public convenience and necessity with the North Carolina Utilities Commission in February 1955, to permit Tapoco to acquire, operate and control certain public utility properties belonging to Nantahala and Carolina Aluminum Company, including the Cheoah and Santeetlah plants and certain transmission lines. In the order granting the certificate, the Commission directed that Tapoco supply to Nantahala the power to satisfy Nantahala's public service load in the two villages of Santeetlah and Tapoco in Graham County. At that time, the two villages had a total population of about 300 people. This certificate is still in effect and Tapoco has never appeared before the Commission to abandon it, or have its terms modified. At the present time, the Village of Tapoco is still in existence and under the terms of the certificate and allocations made pursuant to the Fontana agreements, Tapoco still supplies power to Nantahala, which in turn serves the Village of Tapoco.

In the same month that Tapoco received its certificate of public convenience and necessity from the North Carolina Utilities Commission, it received from the State of Tennessee a certificate of public convenience and necessity to construct and operate the Chilhowee facility. Later in that year (1955), Tapoco contracted to sell its electric distribution system for the City of Alcoa, Tennessee to that municipality. The "City of Alcoa Resolution" which authorized the purchase indicates that the City

planned to look to TVA to supply it with the electric power previously supplied by Tapoco. Thus, Tapoco freed itself of its Tennessee public load and from that point onward, none of the power made available by TVA through the Fontana agreement had to be used to satisfy a Tennessee public load. As a result, Tapoco's share of the TVA return power could be devoted almost exclusively to Alcoa's aluminum production facilities. Notwithstanding the substantial generating capacity of Tapoco's facilities, which is three to four times as great as Nantahala's, Alcoa has historically needed to purchase additional power from TVA to supplement the combined output of its subsidiary power companies. To illustrate, during the test year 1975, Tapoco sold 1,365,499,000 kwh to Alcoa, yet, Alcoa purchased an additional 1,784,833,000 kwh from TVA.

During the period from 1950-1955, Nantahala expanded its facilities to provide additional power to Alcoa to enable it to meet the nation's increased aluminum needs during the Korean War. The major components of Nantahala's East Fork project, the Cedar Cliff, Bear Creek and Tennessee Creek dams and reservoirs were completed between 1952 and 1955. That year, 1955, marked the last year in which Nantahala added hydroelectric generating facilities subject to the coordination and exchange agreement with TVA. No additional generating capacity has been added to the Nantahala system whatsoever since 1957, despite clear indications that Nantahala's public service load was growing.

In this regard, we note that in 1941, Nantahala's public service load was only 25,984,275 kwh. By 1955, this load had increased to 115,735,461 kwh and by 1960, it stood at 172,451,768 kwh. *Utilities Commission v. Membership Corporation*, 260 N.C. 59, 66, 131 S.E. 2d 865, 870. During this same period, from 1941-1960, the relative volume of Nantahala's out-of-state sales to its parent Alcoa consistently outstripped its intrastate public service sales. For example, in 1943, approximately 95 percent of Nantahala's electric generation was sold to Alcoa (320,776,268 kwh), with its public service load receiving the remaining 5 percent (16,493,930 kwh). *Id.*

This imbalance of power consumption between Nantahala's parent and its public load, coupled with Nantahala's assigned role

in "the coordinated operation of power facilities of the Alcoa system and the TVA system,"[9] was observed to adversely affect Nantahala's intrastate rates as early as 1953. In an early Nantahala commercial rate case, *Utilities Commission v. Mead Corp.*, 238 N.C. 451, 78 S.E. 2d 290, Nantahala had sought to increase its rates to all industrial customers other than Alcoa, thus placing the burden of the increase upon the particular group of customers. The undisputed facts were to the effect that Nantahala had been selling more than 80% of its total generation of electric power to Alcoa at a price which was less than the cost of producing and distributing it. The evidence further showed that Nantahala derived the greater part of its revenue from customers other than Alcoa, who consumed only 18% of its power and who were charged approximately twice as much per kilowatt hour as Alcoa was charged. Additionally, it appeared the Nantahala had been earning a return of approximately 6.5% from the revenue collected from its non-Alcoa customers; whereas inclusion of the service and rate paid by Alcoa showed the company to be operating at a loss.

Nantahala sought to justify the differential in rates charged its parent and its public customers by asserting that the vast portion of its generation sold to Alcoa was "secondary" power, while its other commercial customers were supplied with "primary" or dependable power. The Commission approved the increase, finding no unlawful discrimination in this rate structure. On appeal to the Superior Court, the order of the Commission was reversed. This Court, in affirming the judgment of the Superior Court, stated that Alcoa was not entitled to a return on its investment in Nantahala in the form of a preferential rate to the extent it would work to the disadvantage of its subsidiary's other customers. 238 N.C. at 464, 78 S.E. 2d at 300. After noting that the question of "primary" and "secondary" power "was to a large extent the mere application of different labels to that which is essentially the same," *id.* at 465, 78 S.E. 2d at 300, the Court held that the actual differences in service and expense "were in no way comparable to the difference in rates which was so glaring as to compel the inference that it was unreasonable and therefore unlawful." *Id.*

9. *Cf. In re Aluminum Company of America*, 13 F.P.C. at 21.

Justice Barnhill, in a separate concurrence, commented upon one telling aspect of Nantahala's unique posture as a public utility whose largest customer was its parent-aluminum producer:

> Corporations must operate on a profit motive basis. Not so with petitioner. Financed as it is, it can afford—indeed it proposes—to operate at an apparent loss. By so doing it can evade the payment of its fair portion of State and Federal taxes.

238 N.C. at 467, 78 S.E. 2d at 301 (Barnhill, J., concurring).

Beginning in 1960, Alcoa and TVA began re-negotiation of the operational terms of the Original Fontana Agreement which were due to expire at the end of 1962. At the same time, Nantahala and Duke Power Company ("Duke") were engaged in separate negotiations to sell the assets constituting Nantahala's distribution system to Duke, with Nantahala retaining its major generating facilities and transmission lines. The sale would have enabled Nantahala to abandon its North Carolina public service load and to sell all of its generation (or the entitlements therefrom) to Alcoa, just as Tapoco had done. The 1961 Nantahala-Duke sale proposal received initial approval by both the North Carolina Utilities Commission and the Superior Court prior to the negotiation of the final provisions of the NFA in 1962. *See Utilities Commission v. Membership Corporation*, 260 N.C. 59, 131 S.E. 2d 865.

The New Fontana Agreement ("NFA"), dated 27 December 1962, modified and partially superseded the OFA. In essence, however, the NFA contained the same mechanics of power coordination and exchange as the original Fontana Agreement, except that the amount of power TVA was to make available to the Alcoa system under the NFA was fixed in advance by the agreement without regard to water conditions, rather than being calculated on the basis of amount actually generated by the Alcoa system's plants. As it did under the OFA, Alcoa again warranted that it was backing up or securing the performance of its subsidiaries in carrying out the coordination and exchange agreements with TVA.

In contrast to the OFA, which was negotiated and executed by Alcoa and TVA alone, Nantahala and Tapoco were signatory

parties to the NFA, although Nantahala was not a participant in the negotiations. Nantahala's failure to participate is not surprising in view of the Company's pending attempt to sell its distribution system to Duke, and so divest itself of its North Carolina public load. Later in 1963, this Court reversed the Commission's approval of the sale and ordered the case remanded for further consideration because the Commission had failed to make findings of fact with respect to essential aspects of the case and applied too lenient a standard for approval of abandonment of a public service franchise. *Utilities Commission v. Membership Corporation*, 260 N.C. at 68-69, 131 S.E. 2d at 871-72. The Court's discussion of Nantahala's stated reasons for abandoning its public load indicates the company's awareness that its generating capacity would be insufficient to meet its anticipated future requirements. In the wake of the decision, the attempt to sell Nantahala's distribution system to Duke was abandoned.

Under the NFA (still in effect during the test year 1975), TVA dispatched the operations of Tapoco's four plants and eight of Nantahala's largest plants, and received all of the electrical output of these plants. In return, the NFA provided that Nantahala and Tapoco together would receive an annual average of 218,300 kw, part of which was subject to some curtailment and interruption, to be divided between the companies as they saw fit.

The NFA also provided that it was to remain in effect for twenty years—until the end of December 1982. When the agreement took effect in January 1963 it was not on file with the FPC as a tariff or rate schedule and therefore was not examined at its inception for its lawfulness. *See* 30 F.E.R.C. ¶ 63,050 at 65,276. It was not until 1966 that the NFA was filed with the FPC as a tariff or rate schedule under Part II of the Federal Power Act, in response to that agency's request that the companies do so. Both Tapoco and Nantahala (concurring in Tapoco's filing) stated that the filing was "under protest"—that is, undertaken subject to the right to contest the FPC's authority to regulate the operations under the NFA. Moreover, its terms were not formally scrutinized by the federal authorities until after three of Nantahala's wholesale customers filed a complaint raising the matter in 1978. ***See Nantahala Power and Light Co. v. FERC***, 727 F. 2d 1342 (4th Cir. 1984).

The NFA, like the OFA, failed to specify how the power made available to the Alcoa system by TVA was to be divided among the members of the system. On the same day that the NFA became effective, 1 January 1963, Alcoa and Nantahala entered into a subordinate allocation agreement establishing Nantahala's share of the return power entitlements.

The 1963 Alcoa-Nantahala Apportionment Agreement provided that Nantahala was to receive, as its share of NFA entitlements each month, a variable of the larger of one-twelfth of its annual primary energy capability of 360 million kwh or its actual generation. A 1960 Ebasco Study, undertaken for Nantahala by independent experts, had established the average annual generation of Nantahala's plants subject to the NFA at 424 million kwh annually. Thus, under the 1963 Agreement, Nantahala was guaranteed its primary generation and was to benefit from additional generation. Moreover, the agreement provided that Alcoa was to pay Nantahala the sum of $89,200 annually as compensation for allowing TVA to operate Nantahala's projects. Significantly, the 1963 Agreement fixed no capacity or demand limitation upon Nantahala's use of the energy returned. However, unlike the 1954 Alcoa-Nantahala contract which was subordinate to the OFA, the 1963 contract did not impose an obligation upon Alcoa to satisfy any deficiency when Nantahala did not have sufficient power to meet its public load. It appears that the 1963 allocation agreement was never filed with the FPC. *See* 30 F.E.R.C. ¶ 63,050 at p. 65,277; *Nantahala Power and Light Co., Initial Decision*, 15 F.E.R.C. ¶ 63,014, at p. 65,035 (1981).

Between 1963 and 1971 the North Carolina public load, although growing, still remained below Nantahala's primary generation and Nantahala did not need all of its entitlements of 360 million kwh; Alcoa utilized the remainder under its separate agreement with Nantahala. However, by 1971, Nantahala's public load had grown to the point where the utility no longer had excess energy under the NFA to sell to its parent Alcoa. Moreover, by 1971, Nantahala recognized the need to obtain a supplemental source of power to meet the anticipated needs of its public service load in North Carolina. TVA, to whom Nantahala was already interconnected, was chosen as the source of this supplemental power; however, TVA required a formal agreement between Nantahala and Tapoco apportioning their NFA entitlements before it

would negotiate a supplemental power contract with Nantahala. Accordingly, in 1971 Alcoa conducted an apportionment study to measure the energy and capacity contributions of Nantahala and Tapoco. Pursuant to the study made by Alcoa's power consultant, George Popovich, Nantahala executed an apportionment agreement with Tapoco and then entered into an additional purchase contract with TVA.

The 1971 Nantahala-Tapoco Apportionment Agreement (the "1971 Apportionment Agreement") called for Nantahala to fix a limitation on its share of energy from TVA at 360 million kwh annually (*i.e.*, only its primary energy capability). Tapoco was to receive the remainder of the power made available by TVA under the NFA. The 1971 Agreement contained no provision for Nantahala to receive the $89,200 previously provided for under the 1963 Alcoa-Nantahala allocation agreement in compensation for Nantahala allowing TVA to control its facilities.

Simultaneously with the execution of this 1971 Apportionment Agreement, Nantahala entered into a contract with TVA to purchase additional power from that agency. By this agreement, in addition to paying TVA's charge for all energy consumed in excess of 360 million kwh per year, Nantahala was required to pay a charge for the demand of its system above 54,300 kw at any instant. This latter figure represents the capacity limitation assigned to Nantahala under the 1971 Apportionment Agreement with Tapoco.

The 1971 Apportionment Agreement was not filed with the FPC as a tariff or rate schedule for almost ten years, until 1980. *See* 30 F.E.R.C. ¶ 65,030 at p. 65,277; 15 F.E.R.C. ¶ 63,014 at p. 65,035. As had been true of the NFA itself, at the time the agreement became operational, and for the bulk of its life, its terms were not scrutinized by the federal authorities for their lawfulness.[10]

10. We find it noteworthy, as did the Administrative Law Judge in the most recent Nantahala case before the F.E.R.C., that 1982 marked the first time in the forty years since the Alcoa-TVA coordination and exchange agreements had begun, that the Alcoa system had given notice to the F.E.R.C. that it was planning to terminate one of these agreements as well as a separate contract between members of the system and seeking approval in advance for the new agreements which were to supersede the expiring contracts. 30 F.E.R.C. ¶ 63,050, at p. 65,280.

Since the inception of the 1971 Apportionment Agreement, Nantahala has not had available to it for sale, through its portion of return power entitlements, enough electricity to meet its North Carolina public service load. During the 1975 test year, Nantahala generated about 560 million kwh. Despite the fact that its public service load was only slightly in excess of 450 million kwh, Nantahala was constrained to purchase an additional 81,265,370 kwh of electricity from TVA at a cost of $1,500,000, due to the allocational limitations of the NFA and 1971 Apportionment Agreement. 1971 also marked the final year in which Alcoa purchased power from Nantahala, looking instead to Tapoco and TVA to fulfill its energy requirements.

The intervenor's evidence shows that subsequent to that time, Nantahala could have used on its system all of the capabilities it contributed to the TVA system under the NFA and failed to receive back in entitlements of comparable worth. The quantity of power Nantahala purchases from TVA is determined by the magnitude of the shortfall resulting when the hour-by-hour load on the Nantahala system exceeds the level of TVA return entitlements set under the NFA and apportioned to Nantahala under the 1971 Apportionment Agreement. Since 1971, when the annual level of Nantahala's load first exceeded its entitlements, the purchased power costs have become a major operating expense for Nantahala.[11] Thus, Nantahala's contractual arrangements with its affiliates and TVA have dramatically influenced Nantahala's costs in providing service to its public load.

C.

There is apparently no dispute between the parties as to the Commission's authority to implement a roll-in of Nantahala's and Tapoco's properties and financial data for rate making purposes without regard to the separate corporate entities of these utilities, once it has properly determined that these corporate affiliates in fact constitute a single, unified "utility enterprise" or system. The propriety of the separation or rolling-in of properties

11. The "fuel" for Nantahala's hydroelectric generating units is water with no fuel cost. The fuel used by TVA to produce the power it sells to Nantahala is a mix of relatively costly nuclear and fossil fuel. TVA's generation mix contains only a modest increment of hydroelectric generation.

of affiliated corporations for rate making purposes, being merely a step in the determination of costs properly allocable to the various classes of service rendered by a utility, is widely recognized as dependent upon the particular characteristics of the system or systems in question, and upon the facts and circumstances of each case. *See, e.g., Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 89 L.Ed. 1206 (1944); *Central Kansas Power Co. v. State Corporation Commission*, 221 Kan. 505, 561 P. 2d 779 (1977); *Georgia Power Co.*, 52 F.P.C. 1343 (1974). *See generally*, Annot., 16 A.L.R. 4th 454 (1982).

Moreover, as FERC itself has expressly recognized, "the question of whether to treat various entities as an integrated system for rate making purposes is not a purely factual question, but also rests on criteria which each rate making authority may deem relevant." *Nantahala Power and Light Co., Opinion No. 139-A*, 20 F.E.R.C. ¶ 61,430, p. 61,869 (1982). Accordingly, in the parallel FERC wholesale rate case in which Nantahala's wholesale customers advocated the implementation of a roll-in, FERC, while adverting to the fact that the North Carolina Utilities Commission had, "based on a similar record, reached a different conclusion concerning rolled-in costing," *id.*, declined to order a roll-in for determining Nantahala's wholesale costs of service. The Fourth Circuit Court of Appeals, in affirming FERC's determination, stated that "[a] decision to order roll-in is essentially a matter of Commission discretion" which would not be overturned on appeal where supported by substantial evidence. *Nantahala Power and Light Co. v. FERC*, 727 F. 2d 1342, 1346 (1984).

[1] Therefore, it is clear that the North Carolina Utilities Commission has the authority, in the first instance, to determine for itself the relevant criteria to apply to the factual question of whether to treat Nantahala and Tapoco as an integrated system for rate making purposes and its determination will not be disturbed on appeal where supported by substantial evidence. The companies do not contend that the Commission decision is unsupported by substantial evidence; they merely argue that the Commission *ignored* evidence[12] tending to show that Nantahala and Tapoco are separate electric utility companies.

12. We will address this point more fully in Part II, D *infra*.

The Commission's decision of whether to implement a roll-in is based upon a factual predicate consisting of three basic propositions: (1) Tapoco is a North Carolina public utility, subject to the Commission's rate making authority; (2) Nantahala's and Tapoco's hydroelectric facilities constitute a unified, single system, operating under conditions rendering a roll-in appropriate; and (3) Alcoa is a statutory North Carolina public utility, subject to the imposition of a refund obligation in the exercise of the Commission's general rate making jurisdiction. In the record before us, we find plenary evidence in support of the Commission's determination that Nantahala and Tapoco constitute a single, integrated electric system and should be treated as such for the purposes of calculating Nantahala's retail rate base and costs of service.

Upon remand, the Commission held a separate *de novo* hearing on the question of its jurisdiction with respect to Tapoco and Alcoa. Based upon the testimony and exhibits presented at the *de novo* hearing and matters judicially noticed, the Commission, in an order entered 3 October 1980, found and concluded that both Tapoco and Alcoa were subject to its regulatory authority under Chapter 62 of the North Carolina General Statutes.

1.

[2] With respect to Tapoco, the Commission made certain findings of fact regarding its development and acquisition of hydroelectric facilities clothed with public service obligations in North Carolina, most notably, the facilities at Santeetlah and Cheoah. Specifically, the Commission found that Tapoco is a domesticated North Carolina corporation organized to produce and sell electricity; that Tapoco's articles of incorporation provide that one of its purposes is to provide power to the public and those articles authorize Tapoco to exercise the power of eminent domain; that Tapoco has a North Carolina certificate of convenience and necessity to operate the Cheoah and Santeetlah facilities, obtained when it purchased these facilities and certain transmission lines (owned by Nantahala) from its public utility affiliates, Carolina Aluminum Company and Nantahala; that this certificate is subject to the condition that Tapoco provide Nantahala with the power needed to serve the Villages of Tapoco and Santeetlah; that Tapoco's certificate of convenience and necessity

is still active, Tapoco never having petitioned to have its certificate abandoned; that Tapoco has the responsibility to make available a tap point on its station service transformer at the Cheoah power house for Nantahala's use in providing electricity for serving its customers in the Village of Tapoco; and that Nantahala is presently providing service to the Village of Tapoco and charging its customers there for the electricity provided on the basis of rates approved by the Commission. The Commission also made findings with respect to the electricity Tapoco delivers to TVA and Alcoa by virtue of the various intra- and intercorporate agreements discussed above.

The Commission then based its conclusion that Tapoco is a public utility in North Carolina and subject to its jurisdiction on three grounds:

> 1. It is a public utility within the meaning of G.S. § 62-3 (23)a.[13]
>
> 2. It is a public utility for rate-making purposes within the meaning of G.S. 62-3(23)b.[14]
>
> 3. It is a public utility by virtue of having obtained a certificate of public convenience and necessity some twenty-

13. N.C.G.S. § 62-3(23)a provides in pertinent part as follows:

(23) a. "Public utility" means a person, whether organized under the laws of this State or under the laws of any other state or country, now or hereafter owning or operating in this State equipment or facilities for:

1. Producing, generating, transmitting, delivering or furnishing electricity, piped gas, steam or any other like agency for the production of light, heat or power to or for the public for compensation; . . . .

14. N.C.G.S. 62-3(23)b provides:

(23) b. The term "public utility" shall for rate making purposes include any person producing, generating or furnishing any of the foregoing services to another person for distribution to or for the public for compensation.

N.C.G.S. 62-3(21) provides:

"Person" means a corporation, individual, partnership, company, association, or any combination of individuals or organizations doing business as a unit, and includes any trustee, receiver, assignees, lessee, or personal representative thereof.

five years ago, and having operated under that certificate since that time.[15]

Although Tapoco assigned error to the Commission's finding that it is a North Carolina public utility and argued in its brief to the Court of Appeals that the portions of the Commission's order which declare Tapoco to be a "public utility" under North Carolina law should be vacated and reversed, in its new brief to this Court, Tapoco does not challenge the Court of Appeals' affirmation of the Commission's determination that Tapoco is a statutory public utility. Rather, Tapoco presents a single and somewhat confused argument that the Commission "abused its regulatory authority by asserting jurisdiction over Tapoco when it did not and could not regulate Tapoco's rates and service."

Tapoco first argues to this Court, as it did to the Court of Appeals, that the Commission could not "divert" power from the Tennessee industrial load (Alcoa) served by Tapoco's four hydroelectric projects because these projects were licensed by FERC in 1955 to serve that load *exclusively* and the Commission is without authority to impose a state law limitation on the terms and conditions of Tapoco's federal license. Tapoco relies on *First Iowa Hydro-Electric Cooperative v. FPC*, 328 U.S. 152, 90 L.Ed. 1143, *reh'g denied*, 328 U.S. 879, 90 L.Ed. 1647 (1946) and *Town of Springfield v. Vermont Environmental Board*, 521 F. Supp. 243 (D. Vt. 1981) to support its "diversion" argument.

15. N.C.G.S. 62-110 provides:

> No public utility shall hereafter begin the construction or operation of any public utility plant or system or acquire ownership or control thereof, either directly or indirectly, without first obtaining from the Commission a certificate that public convenience and necessity requires, or will require, such construction, acquisition, or operation: Provided, that this section shall not apply to construction into territory contiguous to that already occupied and not receiving similar service from another public utility, nor to construction in the ordinary conduct of business.

In *Utilities Commission v. Telegraph Co.*, 267 N.C. 257, 148 S.E. 2d 100 (1966), we observed that it would be both arbitrary and in excess of the statutory authority of the Commission to grant a certificate of public convenience and necessity to conduct a business which is not a public utility. None of the respondent companies contends that the Commission acted in excess of its statutory authority in granting Tapoco its certificate of convenience and necessity in 1955.

The other portion of Tapoco's argument to this Court, however, was not presented to either the Commission or the Court of Appeals and was not made the basis of Tapoco's assignments of error. That argument, presented now for the first time in this appeal, is that Tapoco has been "misjoined" and should be dismissed as a party to this proceeding because the Commission *did not* grant relief with regard to Tapoco's rates in the Sub 29 (Remanded) proceeding. Accordingly, Tapoco now contends that it was "misjoined" as a party respondent and that under Rule 21 of the North Carolina Rules of Civil Procedure it should be "dismissed forthwith from the instant proceeding," and be awarded the costs of this appeal.

[3] We first note that pursuant to Rule 16(a) of the North Carolina Rules of Appellate Procedure, the scope of our review from a unanimous decision of the Court of Appeals is limited to consideration of the questions properly presented in the new briefs required by Rule 14(d)(1) and 15(g)(2) to be filed in this Court. Rule 16(a) further provides that a party who was an appellant in the Court of Appeals, and is either an appellant or an appellee in the Supreme Court, may present in his brief any question which he has properly presented for review to the Court of Appeals. However, questions properly presented for review in the Court of Appeals but *not* presented and discussed in the new briefs to this Court are deemed abandoned under Rule 28(a). Therefore, Tapoco is deemed to have abandoned and waived further review of the question of its public utility status under North Carolina Law.[16]

A corollary to the rule that this Court's scope of review is limited to questions properly presented to the Court of Appeals is the rule that a party may not present for the first time in its brief to this Court, a question raising issues of law not set out in the assignments of error contained in the record on appeal. App. R. 10. Consequently, the question of "misjoinder" under Rule 21 of the Rules of Civil Procedure, appearing as it has for the first time in Tapoco's new brief filed in this Court, has not been prop-

16. We have, however, under Rule 2 of the Rules of Appellate Procedure, reviewed the Commission's findings and conclusions in the course of our review of the questions properly preserved, find them to be supported by substantial evidence and affirm the Commission's determination as to Tapoco's public utility status on each of the three grounds specified in its orders entered in the Sub 29 (Remanded) proceedings.

erly presented for review and we need not address it in the course of our discussion.

[4] The only questions that Tapoco has correctly preserved for further review are, therefore, whether the Commission is preempted from implementing a roll-in methodology for setting Nantahala's retail rates by virtue of the fact that Tapoco's four hydroelectric plants are under federal license and whether the Commission's order places an indirect burden on interstate commerce by diverting the economic benefits of Tapoco's inexpensive hydroelectric power from its Tennessee industrial customer, Alcoa, to Nantahala's North Carolina public service customers. Inasmuch as Tapoco has merely joined in the brief of Alcoa on the latter point, we will discuss the Commerce Clause issues adverted to by Tapoco in the section of this opinion addressing Alcoa's constitutional argument. With respect to Tapoco's licensing argument, we have little trouble in concluding that the Commission's order has in no way contravened the terms and conditions of Tapoco's federal license.

Under Part I of the Federal Power Act, 16 U.S.C. §§ 791a-823a, the Federal Power Commission (and now the FERC) has exclusive jurisdiction to license the construction and operation of hydroelectric projects on navigable rivers within the United States, and to fix the terms and conditions of any such license. Tapoco's argument that the issuance of its 1955 federal license to construct and operate the four plants of the "Tallassee Project" preempts the Commission from implementing a roll-in is based upon Tapoco's assertion that the plants were licensed by the FPC for "the express purpose of supplying power to Alcoa's Tennessee Operations." We find nothing in the licensing order to indicate that the FPC intended to reserve all of the hydroelectric production from (or economic benefit of) the four Tapoco dams for Alcoa's exclusive use. In its brief, Tapoco places great reliance upon the underscored language contained in a portion of the 1955 licensing order:

> [T]he energy being developed by the constructed developments of the project and the energy to be developed by the proposed development is and will continue to be delivered to the Tennessee Valley Authority, which in turn delivers an equivalent amount of energy to the Aluminum Company of

> America at Alcoa, Tennessee. . . . <u>All the energy is used for aluminum production except for a small portion used for lighting in operators' villages. . . .</u>
>
> * * *

[T]he project is best adapted to a comprehensive plan for the improvement and utilization of waterpower development, and for other beneficial public uses, including recreational purposes.

Deleted from the quoted portion of the licensing order, however, is the revealing opening phrase: "According to the joint application. . . ." It is therefore obvious that the language relied upon by Tapoco, rather than constituting an edict by the FPC that all of the energy produced by the developments comprising the "Tallassee Project," now solely owned by Tapoco, be dedicated to the permanent and exclusive use of Alcoa's private industrial operations, merely contains a restatement by the FPC of the assertions made by Tapoco and Carolina Aluminum Company in their joint licensing application. The order itself contains no express or implied directive from the FPC that the energy produced by these hydro projects be reserved for the sole and exclusive use of Alcoa in its Tennessee aluminum plants, either in the section containing FPC's findings of fact or in its decretal paragraphs.

Moreover, 16 U.S.C. § 802(b) requires that, prior to the issuance of a hydroelectric license, a licensee must submit evidence of compliance with state law "with respect to the right to engage in the business of developing, transmitting, and distributing power. . . ." *Cf.* N.C.G.S. § 62-3(23)a(1). At the time of application, on 25 October 1954, Carolina Aluminum was a North Carolina public utility carrying a public service load in this state and Tapoco was a Tennessee public utility carrying a public service load in that state. On 23 February 1955, before the license was granted by the FPC, Tapoco, which had earlier domesticated in North Carolina, was issued a certificate of convenience and necessity by the North Carolina Utilities Commission to own and operate the Santeetlah and Cheoah facilities. That certificate expressly noted that Tapoco had an obligation to serve the public with electric energy from the projects. When the federal license was issued, it also noted that Tapoco had an obligation to serve the public with electric energy from the projects.

In the 1955 licensing order, the FPC found as a fact that Tapoco and Carolina Aluminum each had submitted satisfactory evidence of compliance with the requirements of all applicable laws for its respective State insofar as necessary to effect the purposes of a joint license for the project, to the extent of the ownership and operation of the project by each applicant. The evidence submitted by joint applicant Carolina Aluminum included its compliance with North Carolina requirements. When, shortly thereafter, the FPC authorized transfer of Cheoah and Santeetlah from Carolina Aluminum and to Tapoco only, it noted that Tapoco had "submitted evidence of compliance with the requirements of all applicable state laws of Tennessee and North Carolina. . . ." 14 F.P.C. at 828.

On the basis of the foregoing, in its final order filed 28 January 1982 the Commission concluded, and we agree, that "[t]o the extent that the federal licenses for Tapoco's dams speak toward dedication of the electric energy, such dedication would of necessity include the using and consuming public of North Carolina." We therefore reject Tapoco's argument as to the preemptive effect of the federal license on the Commission's authority to implement a roll-in methodology in determining Nantahala's retail rates.[17] In any event, as will be discussed *infra*, the roll-in itself does not effectuate a diversion of Tapoco's actual energy production to the North Carolina public load; it merely accomplishes for bookkeeping purposes what is an accomplished fact in the organization and operation of the two companies: the allocation of the combined costs of production for the unified Nantahala-Tapoco system as between the jurisdictional North Carolina retail public load and the nonjurisdictional Alcoa industrial load.

17. We note in passing that the Administrative Law Judge presiding over the latest Nantahala wholesale rate case came to the identical conclusion regarding the intent and effect of the 1955 PFC licensing order. 30 F.E.R.C. ¶ 63,050, at p. 65,290-91. After observing that the FPC had apparently been given insufficient information about the features and consequences of the Alcoa system's coordination and exchange agreements with TVA, and the fact that Nantahala's steadily increasing public load was also serviced under the Original Fontana Agreement, the ALJ concluded that under these circumstances, "with the licensing order silent on such critical points, there is no reasonable basis to conclude that the Commission [FPC] intended to reserve for Alcoa's use alone all of the Tapoco power." *Id.* at 65,291.

2.

[5] The Commission also made findings of fact, amply supported by the evidence of record, as to the existence of a single, unified hydroelectric generating and transmission system consisting of the combined facilities of Nantahala and Tapoco and wholly owned by Alcoa. The evidence in support of these findings may be summarized as follows:

Nantahala and Tapoco are both wholly owned subsidiaries of a single corporate parent, Alcoa. Nearly all of the facilities of Nantahala and Tapoco are situated on the Little Tennessee River and its tributaries. The two power companies are located in contiguous areas in western North Carolina, with portions of Tapoco's physical plant intruding into Nantahala's service area. The Nantahala and Tapoco electric facilities are physically interconnected with each other, with one generation and one distribution connection at Tapoco's Santeetlah facility; power can be dispatched and transmitted from the facilities of one to the facilities of the other. Standing between the two companies' Little Tennessee generation sites is the Fontana project; Nantahala's hydro developments are all located upstream of the Fontana dam, while Tapoco's are all downstream, thus poised to receive the downstream benefits of the Fontana project. Nantahala's eleven developments are smaller and relatively more expensive than Tapoco's four larger developments. The combined resources of the two provide relatively low-cost power and energy under the coordination and exchange agreements with TVA.

The Original and New Fontana Agreements treat the facilities of Nantahala and Tapoco without discrimination and make them an integrated part of, and subject them as a unit to coordination by TVA. By the terms of these agreements, TVA receives the output of all of the hydro resources of both Nantahala and Tapoco, except for three small plants of Nantahala. In addition, the agreements call for Tapoco and Nantahala to turn over to TVA control of production and stream flow. Accordingly, TVA determines for Tapoco and Nantahala, as a single entity, both electric generation and stream flow and operates them as an integrated system and a coordinate part of TVA's own system. In turn, Tapoco and Nantahala jointly receive back from TVA certain entitlements of power which they divide between themselves

by the 1971 Apportionment Agreement. Coordination was regarded as an efficient and economical method to maximize production of electricity from the various plants and to enhance the overall reliability of the pool of power available to the combined system. It is evident from the terms of the Fontana agreements that Alcoa and TVA intended the Fontana project, once it was completed, to be operated together with other TVA generating plants in coordination with certain plants of the combined Nantahala-Tapoco system.

The intervenors' expert engineering witness, David A. Springs, testified at the remanded hearings that it is a "false and arbitrary assumption that NP&L [Nantahala] and Tapoco operate as isolated systems when in fact they do not." When witness Springs was asked whether the Nantahala and Tapoco facilities should be operated as a separate and independent system, he replied: "No, by coordinating them as one with TVA, the outputs of the generating resources are maximized." Springs added that, from an engineering standpoint, the Nantahala and Tapoco facilities should be operated as one utility. With regard to the question of whether Nantahala was designed to operate as part of an integrated system as opposed to operating as a stand-alone company, Springs stated, "NP&L could not have been designed the way it was to ever operate as an isolated system."

Not only was Nantahala designed to operate as an integral part of a larger utility enterprise, but its projects were developed and put into service in accordance with Alcoa's aluminum production needs rather than scheduled in accordance with the size of its public load. The greater portion of Nantahala's capacity, the Glenville (Thorpe) and Nantahala projects, were added in the early 1940's before there was a significant public load in need of their output. Conversely, since the mid-1950's no significant capacity has been added to the Nantahala system, despite clear signs that its public load would place increasingly greater demands upon its facilities. This pattern of development reflects the increased electric power demands of Alcoa on the combined system during the Second World War and Korean War, and its generally decreased and levelized demand in the post-war period.

Springs also testified to the propriety of using a roll-in methodology in determining the appropriate rate base and allocation of

cost responsibility for the customers served by Nantahala's facilities. Springs' conclusion, adopted by the Commission, that a roll-in is mandated in the case of Nantahala and Tapoco, is based upon his analysis of actual company cost responsibilities under the current and historical operating and contractual conditions tying the Nantahala and Tapoco facilities into a single, unified electric system. As Springs explained, cost-of-service rate making is simply a function of rationally assigning to various classes of customers cost responsibility for the facilities available for and used in their service. In cases where facilities are jointly used by two or more groups of customers under circumstances where, for example, a stand-alone method of costing fails to identify appropriate customer loads or where actual customer cost responsibility is distorted by unreasonable power pool agreements a roll-in methodology is appropriate for rate making purposes.[18]

In the case of Nantahala, Springs testified that actual customer cost responsibility for the facilities available for that service cannot be accurately computed on the basis of the percentage of return power entitlements it receives from TVA separate and apart from the total pool of power available to Nantahala and Tapoco as a combined system, because these entitlements reflect neither the generating facilities actually available for Nantahala's retail service, nor the actual use of those generating facilities by those customers. As the intervenors' witness explained:

> A cost-of-service study, whether it be rolled-in or single company, is simply a means of assigning to customer groups the appropriate cost responsibility for the demands the customers place upon the resources of the utility . . . a rolled-in cost-of-service approach [is appropriate] for NP&L and Tapoco, because it is impossible to separate out the functional relationship between the generating resources operated by these companies and the load they each serve.
>
> In a normal utility operation, the ownership of generating resources by particular operating companies reflects the identification of resources to customer loads. In the normal course of development, a utility company will develop the resources in the geographic area, which the customers

18. *See, e.g., Georgia Power Co.*, 52 F.P.C. 1343.

would look to in order to serve their loads. Usually, companies will integrate their resources into a combined system, such as the Southern Company system, and experts might legitimately disagree as to whether it is more appropriate to measure customer demands for service on an individual company basis or a system-wide basis. This is because system-wide needs and the needs of customers of individual companies both impact [sic] the development, planning and operation of power supply resources. *However, in the case of NP&L and Tapoco, I find no significant pattern of power supply development, planning or operation on any basis other than a combined basis.* (Emphasis added.)

In short, it is apparent that the evidence of record overwhelmingly supports the Commission's finding and conclusion that "the Nantahala and Tapoco electric facilities constitute a single, integrated electric system and are operated as such by, and as a coordinated part of, the TVA system," and its further conclusion that, "for purposes of setting Nantahala's rates in this proceeding, the Nantahala and Tapoco systems should be treated as one entity with respect to all matters affecting the determination of Nantahala's reasonable cost of service applicable to its North Carolina retail operations."

3.

[6] Finally, with respect to Alcoa's status as a North Carolina public utility, the Commission correctly noted that despite the fact that Alcoa would not be a statutory public utility under the definitions contained in N.C.G.S. § 62-3(23)a and (23)b, it is a public utility under the definition contained in N.C.G.S. § 62-3(23)c, which provides:

> The term "public utility" shall include all persons affiliated through stock ownership with a public utility doing business in this State as parent corporation or subsidiary corporation as defined in G.S. 55-2 to such an extent that the Commission shall find that such affiliation has an effect on the rates or service of such public utility.

N.C.G.S. § 55-2(9), in turn, provides as follows:

> "Parent corporation" means a corporation which is a dominant shareholder, as herein defined. A corporation through

> which, by virtue of its shareholdings alone, a parent corporation has power to exercise the control which makes the latter a parent corporation is itself a parent corporation. A parent corporation with respect to which another corporation is a parent corporation is a "subsidiary corporation."

Finally, N.C.G.S. § 55-2(6) states:

> "Dominant shareholder" means a shareholder of a particular corporation, domestic or foreign, who by virtue of his shareholdings has legal power, either directly or indirectly or through another corporation or series of other corporations, domestic or foreign, to elect a majority of the directors of the said particular corporation.

Applying these statutory definitions to the respondent corporations, the Commission concluded that (1) Alcoa, as the owner of all of the outstanding stock of Nantahala, a North Carolina public utility as defined by N.C.G.S. § 62-3(23)a, is a parent corporation of Nantahala within the meaning of N.C.G.S. § 62-3(23)c, and is itself a public utility under that section, and (2) that Alcoa's affiliation with Nantahala has had an effect on Nantahala's rates, as evidenced by the terms and results of the New Fontana and 1971 Apportionment Agreements.

We have reviewed the record with regard to these matters and find that the evidence fully supports the Commission's determination that Alcoa is a North Carolina public utility under N.C.G.S. § 62-3(23)c, by virtue of the effect Alcoa's "affiliation" with Nantahala has had upon Nantahala's rates. The historical and current operating conditions tying Tapoco and Nantahala together clearly show that Nantahala is part of a single utility enterprise, created by Alcoa as part of a plan to secure for itself, through the separate corporate entities of its public utility subsidiaries, the large quantities of low-cost power it requires for its aluminum smelting and fabricating operations. Alcoa's unified development of the Little Tennessee River through its subsidiary power companies resulted in the assigning of the system's least expensive utility resources to its exclusive service, through Tapoco, while relegating the relatively expensive portion of those resources to the system's public service load through Nantahala. This development, in turn, has had an enormous impact on the rates Nantahala charged to its retail customers.

Indeed, nearly every major document charting Nantahala's development contains self-referential language describing Nantahala and (later) Tapoco's projects as parts of "the Alcoa power system," that is, the Alcoa power generating and distribution system. For example, in its 1940 application to the Department of War for a national defense certificate of necessity to build its largest hydroelectric facilities, Nantahala stated that the justification for its intended developments at Glenville (Thorpe), Nantahala and Fontana were the enormous electric needs of Alcoa. The application described "the system" which these developments were to be added to as follows:

> At the present time, Alcoa receives power from three dams located on tributary waters of the Tennessee River at Calderwood, Tennessee, and Tapoco, North Carolina (Cheoah and Santeetlah developments). . . .
>
> . . . The new developments will be upstream from the present developments. It is contemplated that they will store water during winter months, and will be used in the dry season to produce additional power and also to make available additional water for the developments downstream. The estimated total addition to *the Alcoa power system* is 51,500 k.w., part of which will be produced at the new developments and part from additional water released for use downstream.
>
> The Glenville project will have installed generating capacity of 21,500 k.w. and will add 17,500 k.w. to *the system*. This power will be used as soon as available for the Alcoa pot line scheduled for January 1941.
>
> The Nantahala project will have installed generating capacity of 42,200 k.w. and will add an estimated 34,000 k.w. *to the system*. It will be completed about August, 1942 and will thereafter supply power for one of two Alcoa pot lines planned for January, 1942. (Emphasis added.)

Similarly, both the Original and New Fontana Agreements, by which Alcoa caused its subsidiaries' hydroelectric facilities to be coordinated in operation with the TVA system, contain references to Alcoa as the "Company" and to the "Company plants" as facilities owned by Nantahala and Tapoco. Article III of the New Fontana Agreement, entitled "Operation of Company's Hydroelectric System," states in part:

> 1. Definitions
>
> For purposes of this agreement, "Company's plants" or "Company's hydroelectric plants" shall mean the following hydroelectric generating plants (and associated diversion dams) which are owned by Nantahala and Tapoco.
>
> * * *
>
> [There follows a list of eight of Nantahala's plants and four of Tapoco's plants.]
>
> The words "transmission facilities of Company," "Company's transmission facilities," and words of similar import shall mean the transmission facilities of Tapoco [and] Nantahala. . . .

In like manner, Article II of the New Fontana Agreement describes the division of rights, benefits and obligations under that contract in terms of a single, integrated system, with Alcoa ultimately guaranteeing the performance of all obligations of the system members thereunder.

> Wherever this agreement provides an obligation or right on the part of Company to generate, sell, or transmit electric power and energy or an obligation or right on the part of Company to own or operate facilities for the generation, sale or transmission of electric power or energy, such obligation or right shall be performed and discharged or enjoyed as the case may be by Nantahala or Tapoco. However, Alcoa warrants and represents to TVA that it will secure the performance of all of the obligations of Company under this agreement.

Of course, Alcoa's involvement in the development, design and operation of the hydroelectric resources of Nantahala and Tapoco is by no means limited to the role of guarantor described above. Perhaps the most succinct and telling account of this role and its purpose is found in the historical study of "the Alcoa story," published in 1952, and entitled *Alcoa: An American Enterprise*. The book, written by Charles C. Carr, who was for many years Director of Public Relations for the company, is a self-professed objective account of Alcoa's history as gleaned from

Alcoa records and files.[19] In the chapter concerning "Water Power," the author explained that in the aluminum business, which requires vast amounts of electricity to produce the metal, electricity is a commodity; an essential part of the cost of every pound of metal along with labor, raw materials, capital investment and the wearing out of equipment.

As early as 1893, Alcoa selected water power as the one source of cheap electric energy best suited to aluminum production. Actuated by the search for low-cost hydroelectric power from its earliest days, Alcoa formed a number of water and power companies in various parts of this country and Canada. When these proved insufficient for Alcoa's growing needs, "Alcoa looked elsewhere for power and located it, about 1909, in the mountains of Tennessee-North Carolina." Carr, *Alcoa: An American Enterprise*, at 93. As Carr observed, "[t]he story of Alcoa's power projects in North Carolina would make a chapter by itself." *Id.* at 95.

> Spurred on by necessity, Mr. Davis and his associates started to acquire riparian properties along the Little Tennessee River and its tributaries in 1910. Studies and plans that contemplated the *unified development of the entire river and its tributaries above Chilhowee, Tennessee, were undertaken.* The assurance of adequate power from that swift-flowing mountain river and its tributaries, *to be developed as needed,* gave Mr. Davis the vision of what is today this country's largest aluminum plant, at Alcoa, Tennessee. On March 6, 1914, the first pot lines of an aluminum reduction works started operating at this location.
>
> The Tallassee Power Company in North Carolina was acquired in 1914 and operated under that name until 1931 when it was changed to the Carolina Aluminum Company. *The Nantahala Power & Light Company was organized as a public utility on July 23, 1929, to develop as needed the power sites which had been owned by the Carolina Aluminum Company*

19. *See* Carr, *Alcoa: An American Enterprise*, "A Note of Explanation," at v-vi (1952). Aluminum Company of America holds the copyright to this publication in its name and portions of the book relevant to this discussion are included as an exhibit in the record before the Commission and on appeal. The intervenors' witness David A. Springs refers to the book in his testimony and the Commission

> *on the upper reaches of the Little Tennessee and its tributaries, the Nantahala and Tuckasegee Rivers.*
>
> *The Nantahala Power & Light Company, a wholly-owned Alcoa subsidiary, is essentially a utility company serving many western North Carolina communities with electricity* to light their homes and to run their motors for commercial, farm and household use. *Its long time President was the late J.E.S. Thorpe, an Alcoa veteran of thirty years' service and well-known utility operator in the Southeast. Mr. Thorpe, who had served as head of Nantahala Power & Light Company for twenty-one years at the time of his death in 1950, was recently honored in a lasting manner by the Directors of Alcoa. The name of a mountain power development, originally known as the Glenville project, was changed to the Thorpe Development.*
>
> *Although its first duty is to serve the communities in its territories, Nantahala Power & Light Company has in its domain such large hydro projects as Glenville and Nantahala, which augment the supply of power in the North Carolina mountains available for aluminum-making.*
>
> * * *
>
> Harnessing the swift-flowing Little Tennessee and its tributaries in their rush through the Great Smokey Mountains is a saga in which many Alcoa veterans have played a part. . . . (Emphasis added.)

Id. at 93-95.

Finally the author discusses what he considers to be the unusual degree of cooperation achieved between "Government" (TVA) and "private industry" (Alcoa) in developing the "fountainhead of the power projects on the Little Tennessee," the Fontana project. According to Carr, Alcoa had purchased nearly all the necessary land in the Fontana basin for development purposes, had found it necessary to become a purchaser of TVA power to supplement its own sources and then, in 1941, "to the surprise of many people who could see 'no good in TVA,' *Alcoa gave to the Governmental authority, without monetary fee, its site at Fontana, where most of the necessary land had been acquired, parcel by parcel, over many years.*" *Id.* at 97. With this

grant, went roadway relocations and engineering data Alcoa had assembled for the construction of the great dam and power project at the Fontana, North Carolina site.

> In return, TVA agreed to build Fontana, the great storage reservoir which would regulate the flow of water at Alcoa's hydro projects and Cheoah and Calderwood, as well as at TVA's downstream projects. Alcoa was influenced in its decision by the Water Power Act of 1920 [predecessor to the Federal Power Act], which would have required the Company to obtain from the Federal Power Commission a license to build Fontana. This license would have given the Government the right to "recapture" the project after fifty years.
>
> *A second part of the Fontana agreement gave TVA the right to control the impounding and release of water to all of Alcoa's hydroelectric developments on the Little Tennessee and to use this generating capacity as an integral part of the TVA power system. In return for this, Alcoa received from TVA approximately the number of kilowatt hours generated at Alcoa plants during a calendar year, and in addition 11,000 KW of primary power without cost. The first part of the Alcoa-TVA agreement, wherein the Fontana project regulates the flow of water at Cheoah and Calderwood, is in perpetuity. The second part, recited in this paragraph, can be cancelled by either party on three years' notice after January 1, 1952.*
>
> * * *
>
> *This agreement made possible the integrated operation of the water powers of Alcoa and TVA, including the Fontana project.* Its result was the maximum production of electric energy from the available water power, not only on the Little Tennessee River but also throughout the entire Tennessee Valley, which is served by the great Tennessee River and all its tributaries. (Emphasis added.)

Id. at 97-99.

Although Nantahala and Tapoco were operating under the New Fontana Agreement and the 1971 Apportionment Agreement during the test year relevant to this proceeding, these agreements were negotiated in the context of the prior Fontana

and apportionment agreements and the operating conditions established thereby. As we have seen, under the OFA, Alcoa (Tapoco) received the benefit of downstream storage derived from TVA's construction of the Fontana project, with no further capital investment by Alcoa. TVA released *in perpetuity* its right to claim downstream benefits against Alcoa in exchange for the transfer of title to the Fontana site. Alcoa caused Nantahala, a public utility with the power of eminent domain, to transfer its title to the Fontana site and its rights to develop that project to TVA, despite the fact that Nantahala was not permitted to be a signatory party of the OFA. Nantahala was not positioned to receive any portion of the downstream storage benefits because it owns no facilities downstream of the Fontana Dam, while Tapoco, and through it Alcoa, was positioned to receive all the downstream benefits because all of Tapoco's projects are downstream of the Fontana site. In addition, Alcoa gave up to TVA a large portion of the dependable capacity from the hydro projects owned by Nantahala and Tapoco.

The New Fontana Agreement, essentially an amendment to the OFA, was signed at the end of 1962, after approximately two years of negotiations between TVA and Alcoa. The 1962 Agreement essentially expanded the coordination of the two systems by fixing the availability of capacity and energy returned from TVA without regard to stream flow conditions. However, in the bargain, dependable hydro capacity was traded away in exchange for improvements in the availability of energy for aluminum production. This produced a significant increase in the degree of availability of secondary energy to Alcoa. This energy, subject to prolonged periods of interruption, is unsuited to the needs of a public load, which requires peaking capacity to meet fluctuating customer demands. As it had done with the OFA, Alcoa, now through its employee George Popovich, represented its own interests and those of Tapoco and Nantahala in the negotiations with TVA over the NFA's terms and conditions. Nantahala itself had no direct participation in the negotiations. Significantly, the Alcoa negotiation paper, entitled "NOTES ON MEETING WITH TVA —MARCH 2, 1962," refers to the pending transfer case and rate case then before the Commission as the "Nantahala problems."

It is evident that prior to this Court's action in *Utilities Commission v. Membership Corp.*, 260 N.C. 59, 131 S.E. 2d 865, Alcoa

personnel had believed that the sale to Duke was to be approved. Thus, an Alcoa memorandum entitled "*RE: FONTANA AGREEMENT*" dated 23 August 1960, concludes as follows:

> *One final note, the entire TVA proposal is based upon the sale of the Nantahala Power Company.* TVA proposed that if the sale was not complete at the time this new proposed contract becomes effective, they would increase the power available to us under the purchase contract to whatever amount is necessary for us to handle the Nantahala loads. . . . This would be done on a temporary basis and would be reduced concurrent with the transfer of the Nantahala properties to Duke. (Emphasis added.)

The final Alcoa memorandum after completion of all negotiations for the NFA, dated 6 November 1962, reflects the continuing intention on the part of Alcoa to accomplish the transfer of Nantahala's distribution system and public service load to Duke. However, no revisions were thereafter made to the NFA or to the purchase and apportionment agreements subordinate to it to take into account the growing public load serviced by Nantahala. In addition, the Commission found that the NFA's structure rendered it necessary for Nantahala to enter into the subordinate 1963 Apportionment Agreement with Alcoa, five days after the signing of the NFA, in order to secure Nantahala's participation in the TVA return entitlements. This was done by means of a monetary supplement from Alcoa to Nantahala and a guarantee of a certain share of power entitlements from the TVA return.

The Commission concluded that the foregoing evidence clearly demonstrates that the NFA was tailored to meet Alcoa's aluminum production needs without consideration of Nantahala's public service needs and that this arrangement had a considerable impact on Nantahala's rates.

By the time the 1971 Apportionment Agreement was signed, the interconnected power supply structure had long been in place, and Nantahala found itself without sufficient power to service its public load, which had been growing at an annual rate of approximately 8.5 percent. Having added no additional generating capacity, since 1957, and having failed to enter into other power supply contracts tailored to its public load requirements, Nantahala found itself in the position of having to make supplemental pur-

chases of power from TVA and passing those additional costs along to its public customers in the form of increased rates.

Again, it was an Alcoa employee, George Popovich, who conducted the 1971 apportionment study and devised the apportionment formula that was incorporated into the 1971 Agreement between Tapoco and Nantahala. Moreover, during the course of the negotiations "between" Nantahala and Tapoco over the division of return power entitlements, Popovich apparently represented the interests of *both* Nantahala and Tapoco at the "bargaining table." When questioned as to his role, Popovich conceded that he wore "both their hats" during these negotiations adding merely that in view of Nantahala's public utility responsibilities, "I think my Nantahala hat was bigger than my Tapoco hat." At this point, we note only that in its examination of the results of these contractual arrangements upon Nantahala's retail costs of service, the Commission came to precisely the opposite conclusion.

The net effect of Alcoa's "affiliation" with Nantahala is evidenced by a pattern of operation of Nantahala's power supply resources under the various Fontana and apportionment agreements largely inconsistent with and ultimately detrimental to, its ability to render service at just and reasonable rates to its retail customers. Further, as the Commission itself concluded, "Nantahala was not designed as, and is not in reality, a separate utility system but, rather, is a part of an integrated Alcoa system with Tapoco."

Moreover, Alcoa's involvement in the development of Nantahala's and Tapoco's North Carolina hydro resources does not stop with these contractual arrangements. Rather, as this Court noted in *Edmisten*, Alcoa's role also extends to "the ultimate operating and accounting policies of both utilities. The chief executive officers of both Nantahala and Tapoco report directly to an Alcoa vice president. Members of the board of directors of both utilities are employees of Alcoa." 299 N.C. at 435, 263 S.E. 2d at 586. Indeed, Nantahala's president, William M. Jontz, had his original employment conversations with Alcoa officials in Pittsburgh, Pennsylvania. Although his employment as president of

Nantahala began on 1 June 1976, he did not meet with the Nantahala Board of Directors until the latter part of July 1976.[20]

Similarly, the president of Tapoco is a direct employee of Alcoa serving in the dual status of power manager of Alcoa's Tennessee operations and president of the utility company. His sole office is located at Alcoa's south main plant at Alcoa, Tennessee. Furthermore, Alcoa owns 100 percent of the capital stock of Nantahala and Tapoco. The assistant controller of Alcoa, Robert D. Buchanan, testified that he has the "general responsibility for the financial accounting for Alcoa and its subsidiaries, and as such ha[s] responsibility for the books and records and financial policies of Tapoco and Nantahala."

The foregoing evidence manifestly demonstrates the substantial and detrimental impact Alcoa's "affiliation" has had upon Nantahala's rates and service to its North Carolina public utility customers, and fully supports the Commission's conclusion that Alcoa is a North Carolina public utility under the provisions of N.C.G.S. § 62-3(23)c.

In summary, the evidence of record gathered at the remanded hearings before the Commission in this general rate case establishes beyond question three basic propositions: (1) Tapoco is a North Carolina public utility; (2) the hydroelectric facilities of Nantahala and Tapoco constitute a unified, single system, operating under conditions rendering a roll-in rate making methodology appropriate; and (3) Alcoa is a statutory North Carolina public utility to the extent that its affiliation with Nantahala has affected Nantahala's rates.

20. Significantly, Nantahala's employment contract with its president describes the "major general objectives" of such employment to include both the company's management *and* the development of plans "for the possible sale or other disposition" of Nantahala, said goals to be accomplished "so that there is little or no adverse impact on the operations and assets of Nantahala's parent company [Alcoa] and its subsidiaries in North Carolina, including, but not limited to, . . . Tapoco, Inc. and Yadkin, Inc. . . ." Under the section governing base salary, the contract provides for achievement awards based upon the president's performance with respect to these objectives, "To be determined annually by the three-member [Alcoa] group among the Board of Directors of Nantahala. . . ." Finally, under provisions entitled "Nondisclosure," the president is not to engage in any act which would, *inter alia*, tend to prejudice the business of "Nantahala *or* of Nantahala's parent company [Alcoa] and its subsidiaries . . . Tapoco, Inc. and Yadkin, Inc.

D.

The Commission, after finding that Nantahala and Tapoco are a single, integrated electric system, joined the assets, properties, plants and working capital requirements of both companies into a unified rate base, totaled joint revenues and operating expenses, and assigned the combined system the rate of return approved for Nantahala alone in the 1977 proceedings. From these elements, a combined system revenue requirement was derived. These aspects of the Commission's order are not challenged by the companies. However, the controversy between the intervenors and the companies over the proper cost allocation methodology to be used in apportioning the combined revenues, expenses and investment of the unified system between the retail customers in North Carolina and the non-jurisdictional Alcoa industrial load in Tennessee lies at the heart of this appeal.

Generally speaking, the allocation methodology proposed by the companies through their expert witness Herbert J. Vander Veen assigns customer cost by utilizing the entitlements of the New Fontana Agreement and the 1971 Apportionment Agreement; whereas the allocation methodology proposed by the intervenors through their expert witness David Springs, and adopted by the Commission, is grounded upon the assignment of cost responsibility to the public load and to Alcoa on the basis of which load actually used the capability available from the generating facilities of the combined system. The jurisdictional allocation factors utilized by the Commission are generally accepted factors commonly employed by the Commission in setting intrastate retail rates for other public utilities serving in more than one jurisdiction. The unique problem posed by this case lies in the fact that Nantahala's available power supply was contractually reshaped by the quantity and design of the entitlements returned by TVA under the NFA and allocated to Nantahala under the 1971 Apportionment Agreement. In effect, the companies treated Nantahala as part of a unified system when dealing with Nantahala's contribution to the pool of power turned over to TVA and with respect to TVA's dispatch of Nantahala's facilities, but not when determining Nantahala's share of the entitlements returned to the Alcoa system. Thus, Nantahala's share was computed *as if* Nantahala were a stand-alone company. In the process, Nantahala

received little or no value in return for certain contributions it made to the integrated system.

The Commission, in rejecting the companies' proposed allocation methodology, reasoned that it would be unjust to Nantahala's retail rate payers to allocate demand and energy related costs on the basis of TVA return entitlements because the terms of the NFA had been structured to meet Alcoa's industrial needs and not Nantahala's public service needs. Moreover, the combination of the NFA and the 1971 Apportionment Agreement forced Nantahala to purchase costly additional power irrespective of its production capacity. The companies argue that the Commission was constrained by the doctrine of federal preemption to utilize the NFA demand and energy entitlements in determining Nantahala's demand and energy related costs because the NFA and 1971 Apportionment Agreement are FERC-filed wholesale rate schedules, the reasonableness of which may not be reinvestigated by state public service commissions, and the economic results of which must be accepted in setting retail rates. Additionally, they argue that the manner in which the Commission allocated the rolled-in costs places an impermissible burden upon interstate commerce by affording North Carolina customers a "first call" on both the energy output of the combined system and the economic benefits of Tapoco's lower-cost production. A proper understanding of our conclusion in Part II, A and B, *infra*, that the Commission is neither preempted by the Federal Power Act and Supremacy Clause, nor forbidden by the Commerce Clause of the United States Constitution from implementing the rolled-in rate making methodology developed in this case necessitates a brief review of the Commission's findings with respect to the power supply agreements at issue.

Initially, it must be pointed out that the Commission's discussion of the NFA and 1971 Apportionment Agreement occurred in the context of addressing the impropriety of basing *cost allocations* on demand and energy entitlements as contained therein. The Commission was not concerned with the reasonableness of the power exchange agreements and associated system costs *per se*, but with the question of which load should be held responsible for which portion of these costs in its rates. Put another way, it is evident that the Commission's in-depth examination of the terms of these contracts was undertaken as part of its process in choos-

ing between the competing jurisdictional cost allocation methodologies presented by the parties and not in an effort to either reform the contracts or to alter the actual flow of return power thereunder.

In some twenty pages of its rate reduction order, the Commission exposed and "fleshed out" the extensive network of detriments and inequities to Nantahala and its customers embedded in the terms of the NFA and 1971 Apportionment Agreement. In essence, the Commission found that a disproportionate amount of the capacity and energy resources of the combined Nantahala-Tapoco system, perfectly usable by the load characteristics of the Nantahala public load, were traded away to reform the TVA return entitlements to fit the needs and characteristics of an aluminum smelting and fabrication operation. Because Nantahala is structured, operated and treated as an integral unit of the combined system, rather than as a stand-alone company, the detriments it incurs under the integrated system's power supply contracts result in concealed benefits flowing to Tapoco, and ultimately to its parent and customer, Alcoa. While "costs" charged to the combined system under these contracts might be considered objectively fair and reasonable from the wholesale perspective, the public customers of Nantahala were found to have fared badly when that utility was artificially separated out of the unified system for allocation purposes, and then forced to bear the added responsibility for costs of purchased power from TVA.

The Commission found a number of specific inequities in terms of cost responsibility to Nantahala and concealed benefits to Alcoa arising out of both the NFA and 1971 Apportionment Agreement, and divided its treatment of these agreements into separate discussions. Another portion of the order analyzes the manner in which the companies employed the data contained in the agreements in developing their cost allocation methodology. Finally, the order discusses the mechanics of the allocation adopted by the Commission from the proposal of the intervenors and utilized in fixing Nantahala's rates. We will use the subject headings corresponding to those portions of the order in our summary of the discussion contained therein.

Concealed Benefits of the Apportionment Agreement

(1) Quantity of Nantahala's Production.

In 1962, Alcoa power consultant George Popovich determined that under the NFA, Nantahala should be apportioned annual energy entitlements guaranteed at minimum, to return to Nantahala an amount equivalent to its primary energy capability of 360 million kwh plus its actual production in excess of that amount, which was 79 million kwh of average energy; 66 million kwh when Nantahala's non-Fontana generation is taken out. Popovich's 1962 figures were derived from an independent engineering study made by Ebasco in 1960 for Nantahala, and accepted by Alcoa as the basis for Nantahala's entitlements under the 1963 Alcoa-Nantahala Apportionment Agreement. By that agreement, Nantahala received annually an average of 426 million kwh, of which 360 million kwh was guaranteed as a minimum. The 426 million kwh of return power was approximately the same amount as Nantahala contributed to TVA under the NFA. Yet despite these facts, when Popovich devised the 1971 Apportionment Agreement, Nantahala received only 360 million kwh annually. Thus, Nantahala was deprived of an average of 66 million kwh annually. The Commission concluded that this detriment to Nantahala constitutes a benefit to Tapoco that is passed on to Alcoa.

(2) Quantity of Nantahala's Peaking Capacity.

The 1960 Ebasco Study computed Nantahala's plant capacity, under the most adverse water conditions, at 85,400 kw. After deducting the three small plants excluded from the NFA, that capacity is 84,300 kw. Alcoa's acceptance of these computations is reflected in a number of internal documents cited by the Commission in its order. As was true of the energy entitlements, this study formed the basis of Nantahala's capacity entitlements in the 1963 Alcoa-Nantahala Agreement. Under it, Nantahala was permitted to use capacity without a pre-set limitation. Therefore, Nantahala was able to use actual capacity to the limits assigned by the 1960 Ebasco Study in meeting its customer demands. However, when Popovich conducted his study for the 1971 Apportionment Agreement, while accepting the most adverse water (*dependable*) capacity factor of 84,300 kw, he deducted 27,500 kw for the "largest unit out" to reach an *assured* capacity of 54,300

kw. This deduction is for the Nantahala facility which forms upwards of 50 per cent of the entire Nantahala generation system of 11 dams. Thus, under the 1971 Apportionment Agreement, Nantahala was assigned a peaking capacity of 54,300 kw. The result of this limitation is that any time Nantahala has to provide a customer demand in excess of 54,300 kw, it must pay a monthly demand charge to TVA for all power over that limitation. If the limitation were set at Nantahala's capacity level determined by the "loss of load probability" method, the monthly demand charge would be only the amount between 81,800 kw and the excess customer demand over and above that amount. The Commission concluded that demand costs thereby imposed on Nantahala for use of capacity between its assigned capacity of 54,300 kw and its assured capacity of 81,800 kw, would represent an expense to Nantahala and thus a savings to "its New Fontana Agreement sister, Tapoco," since the capacity constraints for the TVA return entitlements are jointly shared by them under the NFA.

The difference in amount between the capacity assigned to Nantahala under the 1971 Apportionment Agreement and what the Commission has determined its assured capacity to be results from the different methodologies employed by the companies and the intervenors in determining Nantahala's assured capacity. The intervenors' witness Springs testified that the proper reserve margin for Nantahala should be the margin used by TVA, which is "the loss of load probability" method. Use of this method would recognize that Nantahala is operated as part of the coordinated Alcoa-TVA system rather than as a stand-alone utility, and would result in a reserve requirement of about 3 per cent. Using a 3 per cent reserve in place of the "largest unit out" reserve, which, in this case is upwards of 50 per cent, would establish a capacity under the most adverse water conditions of 81,800 kw as opposed to Popovich's calculation of 54,300 kw.

The Commission concluded that significant cost is shifted to Nantahala by the unfair and unwarranted limitation of its capacity to 54,300 kw; conversely, that expense, in the form of demand charges paid to TVA, is a concealed benefit to Alcoa. The basis for the Commission's conclusion that the capacity limitation assigned to Nantahala under the 1971 Apportionment Agreement was unwarranted lies in the Commission's rejection of the "larg-

est unit out" adjustment to actual capacity for reserves in computing Nantahala's assured capacity. The order states as follows:

> *If* Nantahala were a separate and independent system, a deduction of the "largest unit out" might be appropriate to determine assured capacity. *However, Nantahala is not and never has been a separate electric system—it was not so designed.* Nantahala's two largest facilities are Thorpe (previously Glenville), . . . and Nantahala, ... The Thorpe and Nantahala facilities comprise about 65% of Nantahala's entire system. At the time of their construction, *Alcoa obtained a certificate of necessity from the War Department and expressly argued and avowed that they were part of the Alcoa system.* . . .
>
> *Furthermore, for the past 40 years, both Nantahala and Tapoco have been operated as an integral part of the TVA electric system pursuant to the provisions of the Fontana and New Fontana Agreements. Moreover, when Alcoa negotiated these agreements with TVA, it did not bargain for return power from TVA as if Nantahala was an independent power system but rather the attributes of the Alcoa system were melded together, with the TVA system for evaluation purposes.* . . .
>
> *With Nantahala and Tapoco being thus integrated into and coordinated with the TVA system, it is not appropriate to determine Nantahala's assured capacity by configuring Nantahala as a single independent and isolated system and to use the "largest unit out" methodology.* Instead, Nantahala should be treated as part of the TVA system and the reserve margin used by TVA should be applied. TVA does not use a reserve of "largest unit out" but rather uses "the loss of load probability method." (Emphasis added.)

(3) Nantahala's Upstream Benefits.

Nantahala's projects are upstream of Tapoco's projects, with the exception of Santeetlah. As a consequence, water that is stored by Nantahala can be released to flow downstream and be used by Tapoco for production of electricity. Therefore, Nantahala's storage has a value to Tapoco which is undiminished by the fact that TVA's Fontana Project now lies between Nantahala and Tapoco. A 1956 TVA study estimated the upstream storage benefits of the two major Nantahala projects to be a continuous relative contribution of 4,300 kw to Tapoco's downstream Calderwood and Cheoah projects. This is an equivalent of 37,668,000 kwh annually as an upstream benefit from Nantahala to Tapoco. However, under the 1971 Apportionment Agreement, Nantahala received no credit for this benefit to Tapoco, which was in turn passed on to Alcoa.

(4) Nantahala's Entitlement for Operating Its Properties in Accordance with the Fontana Agreement.

By the 1941 Fontana Agreement, Nantahala, at the instance of Alcoa, gave to TVA the right, *in perpetuity*, to control the storage and flow of water from its several hydroelectric projects. The Commission found that Nantahala's giving up of rights unquestionably constituted a loss of considerable value for which Nantahala was entitled to compensation. With the 1963 Alcoa-Nantahala Apportionment Agreement, Alcoa agreed to continue to pay to Nantahala monies for Nantahala's loss of those operational rights. Moreover, the agreement clearly showed that TVA was continuing to pay value for those rights, which value is reflected in the TVA return entitlement of the New Fontana Agreement. This fact was also reflected in the Commission's own earlier findings with respect to the TVA return entitlement in the year 1963 in Docket No. E-13, Sub 13. Yet despite the fact that the NFA includes in the TVA return entitlement a reimbursement by TVA for the right to operate Nantahala's projects, for which Alcoa previously paid $89,200 annually to Nantahala, no credit was given to Nantahala for that entitlement under the 1971 Apportionment Agreement. In other words, Nantahala receives neither an energy credit nor a monetary payment for the right given up. The Commission concluded that since the TVA payment for the operational rights, which is paid with energy in the NFA rate entitlement, did not go to Nantahala, it inured to the benefit of Tapoco, which, in turn passed this benefit to Alcoa.

(5) Nantahala's Value to the TVA Interconnected System.

The Commission found that another failure of the 1971 Apportionment Agreement regarding Nantahala's participation is that the Popovich apportionment formula does not consider the

proper value to TVA of the fact that Nantahala, Tapoco and the TVA systems are interconnected.

> Interconnection is of considerable value to TVA completely aside from the fact that Nantahala's rate base includes in it certain assets devoted to the interconnection, which assets are entitled to earn a rate of return. Because Nantahala is not an isolated system, it should be receiving the usual benefits that accrue from coordinated operation. Yet, Nantahala does not receive the usual benefits of an interconnected and coordinated system.

Relying on Alcoa documents reflecting the path of its negotiations with TVA over the New Fontana Agreement, the Commission found that the integrated systems factor was recognized by Alcoa to be of great value to TVA, a recognition that Alcoa was able to capitalize on later in arriving at the final terms of the agreement. As indicated, some of the values of integration are the need for smaller reserves and the fact that TVA actually controls production of generation and storage waters. However, one of the larger benefits is the value in integration of Nantahala's projects that are upstream of TVA's Fontana Project. The Commission noted that in an integrated system such value is maximized; Nantahala's projects contributed upstream benefits not only to Tapoco's downstream projects, but also to TVA's downstream Fontana Project. In fact, the entire TVA Tennessee River system receives the benefit of the storage of all of these projects located on the Little Tennessee River. This is especially so given TVA's control of all of the Nantahala and Tapoco reservoirs under the terms of the Fontana Agreement. Based upon the results of a TVA study of combined downstream storage benefits, the Commission determined that Nantahala's annual upstream benefit to TVA is 70,956,000 kwh.

However, when the NFA bargain was struck, the TVA and the Alcoa systems agreed to cancel out their respective upstream benefits. The Commission observed that since Nantahala provided benefits upstream to both Tapoco and TVA, and TVA provided benefits upstream to Tapoco, it was Tapoco that gained by the mutual cancellation, to the detriment to Nantahala of the value of 70,956,000 kwh annually. The Commission further concluded that Nantahala should have received back an equivalent amount of

energy under the 1971 Apportionment Agreement from Tapoco. Because Nantahala received no such benefit under the Popovich apportionment formula, the Commission concluded that to Tapoco's benefit, Nantahala was deprived of one value of the interconnection with the TVA system. This concealed benefit flowing from Nantahala to Tapoco, is of course, passed on by Tapoco to Alcoa.

In summarizing its discussion of the detriments to Nantahala from the 1971 Apportionment Agreement, the Commission totalled the annual kilowatt hours which Nantahala contributed in average production to the system and for which no credit was received in return and determined that Nantahala was deprived of a total value of 200,224,000 kwh annually. In addition to which, Nantahala received no credit for its peaking capacity over the 54,300 kw which was assigned to it, as a result of which Nantahala must pay additional demand charges to TVA when monthly demand exceeds assigned capacity. After quoting a portion of this court's opinion in *Edmisten* regarding the terms of the 1971 Apportionment Agreement, the Commission concluded:

> Now that considerably more of the various detriments to Nantahala have been exposed and fleshed out, it is apparent that the 1971 Apportionment Agreement works an extensive injustice on Nantahala and its public rate payers, the gravity of which far exceeds even that envisioned by the Supreme Court.

Concealed Benefits of the New Fontana Agreement

The Commission found the concealed benefits flowing from Nantahala to Alcoa by virtue of the NFA to be entirely different in nature from those which flow from Nantahala to Tapoco, and ultimately to Alcoa from the 1971 Apportionment Agreement. The basic inequity to Nantahala arising out of the NFA is that the energy entitlement returned to Nantahala and Tapoco from TVA is structured to meet Alcoa's demand for a certain amount of stable electricity for purposes of aluminum production rather than a demand for a public load. Consequently, the NFA returns to the system an average of 218,300 kw of energy at a high load factor with minimal peaking deviation, which is principally designed to service Alcoa's pot-lines and other production electrical

requirements. Even the interruptible and curtailable energy entitlement returned to Nantahala-Tapoco is in increments of wattage that conform to the demands of a pot-line so that, if power is interrupted or curtailed, Alcoa can respond by cutting out a particular pot-line.

Nantahala, on the other hand, has a fluctuating demand for energy which has peaks and valleys. Its electrical requirement is for assured, but constantly variable amounts of energy. Nantahala needs peaking capacity and its generation projects possess peaking capacity, yet the NFA traded away that peaking capacity to TVA. The Commission agreed with the intervenors that the trade-off of Nantahala's own peaking capacity, at a time when Nantahala's load required such peaking capacity, thus forcing the utility to purchase capacity back at a higher price from TVA, was not the result of "enlightened, arm's-length bargaining" and that the detriment resulting to Nantahala from the design of the NFA entitlements flows to Alcoa as a benefit.

In fact, the intervenors' evidence demonstrated that Alcoa reaped enormous benefits through the trade in the improvement of the availability of Tapoco's secondary energy production *from* a level of 42 per cent average curtailment *to* an average curtailment rate of only 8 per cent. In addition, Tapoco's generation statistics reflect the benefits of coordination with the Fontana Project and other forms of integration with TVA. These figures are inconsistent with the isolated system model utilized as a basis for the 1971 Apportionment Study. Again, it was evident that the two operating subsidiaries were treated as a single system for purposes of bargaining with TVA over the value of their combined contribution to the TVA system, and were only separated out as if they were independent systems for the purposes of dividing the return entitlements between them.

The Commission noted that "Alcoa was in direct control of the [NFA] negotiations, and, unlike the Nantahala ratepayers, has had every ability to protect its own interests during the negotiations. Respondents cannot now be heard to claim that they are dissatisfied with the NFA so as to place the cost responsibility for the deficiencies of that agreement upon Nantahala's ratepayers." In explanation of the design of the NFA, the Commission observed that during the negotiation stage of the NFA, the par-

ties contemplated the sale of Nantahala's distribution system to Duke. The sale would have left Nantahala with its generation, but without a public service load, so that all of its NFA entitlements would be satisfactory for delivery to Alcoa irrespective of quantity and design; in no manner was the NFA structured to meet Nantahala's public service needs.

Next, in passing, the Commission rejected the remedy of regulatory reformation of the NFA to properly award to Nantahala its just entitlements as, of necessity, somewhat hypothetical at this stage of the case. Rather, for cost allocation purposes, the Commission concluded that the "roll-in technique avoids the need for complete identification of inequities and is nicely suited as a proper alternative to reformation of contracts." On the basis of its discussion of the various "detriments" to Nantahala resulting in "benefits" to Alcoa, both directly and through Tapoco, and "upon careful consideration of the entire evidence of record," the Commission concluded that it should reject the companies' proposed allocation methodology in that "said methodology in all material respects is based upon the New Fontana Agreement and the Tapoco-Nantahala Apportionment Agreement." Under a separate heading, the Commission discussed the manner in which the companies employed the data contained in the NFA and the Apportionment Agreement in greater detail to show why their allocation methodology was not proper for computing Nantahala's retail costs of service.

The Mathematics of Allocation

In this portion of the order, the Commission described the competing allocation methodologies presented by the companies and the intervenors for determining Nantahala's demand and energy costs. In general, the method proposed by the companies' witness Vander Veen derived the demand and energy charges from the demand and energy entitlements allocated to Nantahala under the NFA and 1971 Apportionment Agreement.

Vander Veen's Nantahala-Tapoco roll-in cost of service study differs fundamentally from the study submitted by the intervenors' witness Springs in that Vander Veen includes the *entire* Alcoa load served by Tapoco *and* TVA for purposes of computing the Nantahala-Tapoco system's demand allocation factor. In other words, Vander Veen adjusted Tapoco's 1975 book figures to re-

flect a non-utility, 235 Mw direct power purchase by Alcoa from TVA pursuant to a separate, non-Fontana Alcoa-TVA purchase contract as if it were part of the Nantahala-Tapoco system's *generating* resources. With this non-utility addition to the system's power supply, Vander Veen performed a demand allocation which assumed that the system peak occurred at the hour of the Nantahala system peak in 1975, and that at that hour Tapoco had available to serve the Alcoa load both Tapoco's NFA entitlements and the full amount of the Alcoa purchase contract (as adjusted) of 235 Mw.

In addition, for demand cost allocation purposes, Vander Veen's method recognizes the distinction between firm and non-firm NFA entitlements. He used only the firm power available under the NFA to meet system demand, thus removing entirely the amount of capacity that can be curtailed and interrupted from the capacity available to serve system load. As the Commission found, the upshot of this technique is to render 90 Mw of actual return entitlements *valueless* for meeting the system demand at any time, whether or not power is actually curtailed, and even when there may be additional make-up demand. Another 1/16th (*i.e.*, 15 Mw) of the 90 Mw interruptible power returned by TVA under the NFA was also taken out of Tapoco's demand allocation, so that a total of 105 Mw was removed for both the curtailable and interruptible power, and rendered valueless for cost allocation purposes. The effect on Nantahala's costs of Vander Veen's technique is to dramatically increase Nantahala's proportionate share of the demand charges even though both Nantahala and Tapoco take under the NFA and Tapoco takes three times as much power as Nantahala.

In contrast to the foregoing cost of service analysis, the intervenors' evidence showed, and the Commission accepted, that the non-utility direct industrial purchases that Alcoa makes from TVA are not properly considered a *utility* function of either Tapoco, Nantahala or the combined utility system of both and so are not properly includable in the cost of service allocation. Furthermore, the demand credit Vander Veen assigns to Alcoa because of the interruption and curtailment features of the NFA is not supported by the actual features of the unified system. The Commission adopted the view taken by the intervenors' witness

Springs that use of only firm power available to meet system demand distorts rather than reflects customer cost responsibility.

> Although it is not unusual for an industrial customer to receive a credit for accepting interruptible power, the rationale for this is that the utility providing the service to that customer will save the cost of carrying reserves. The ability of a utility to provide such credits is limited by its need for reserves. There should be no credit for interruptions which do not result in cost savings to the supplying utility. Mr. Vander Veen's demand credit unfairly assigns to other customers the fixed costs necessary to generate the power traded to TVA for this curtailable and interruptible power. The fixed costs of investment, operation, and maintenance for these plants do not cease when TVA curtails delivery to Alcoa under the contractual arrangements.

The Commission accepted the intervenors' evidence that the return entitlements result from the investment, maintenance and operation costs necessary to make the hydroelectric generation of Nantahala and Tapoco available for TVA's demands. Ultimately, the companies' approach was found to unfairly burden the public customers by requiring them to bear costs properly assignable to Alcoa for the fixed costs necessary to generate the power traded to TVA. The Commission again described the reasons why the NFA trade-off distorted customer cost responsibility, and was therefore improper to use as a basis for computing Nantahala's demand and energy costs.

> In essence, the NFA is a trade-off of certain firm power and secondary power, available less than 50% of the time, for lesser amounts of firm and secondary power that are curtailable and interruptible but available more than 50% of the time, since any power available more than 50% of the time is usable by Alcoa in its aluminum smeltering operations. *The trade-off result is a considerable improvement in the value of Tapoco's energy useable for Alcoa's aluminum production. The trade-off has no value to the public load. Alcoa (Tapoco) should, therefore, take full cost responsibility for the demand-related costs associated with the capacity traded off.*

In conclusion, the Commission stated that the companies' proposed demand allocation technique would result in a "gross ineq-

uity" to Nantahala and the public load customers, and that demand and energy charges should properly be based upon the capabilities and needs of Nantahala and Tapoco outside of the TVA return entitlements.

Next, the Commission discussed the intervenors' proposed cost allocation methodology and concluded that in view of "the entire evidence of record with respect to the assignment of cost," this method would be employed to determine Nantahala's demand and energy related costs. The data accepted by the Commission as representing the capabilities and needs of the Nantahala-Tapoco unified system appropriate for use in the allocation of demand related costs is as follows:

A. Dependable Capacity for NP&L Projects	85.4 Mw
B. Dependable Capacity of Tapoco Projects	302.8 Mw
C. Total (A + B)	388.2 Mw
D. Less Reserve at 3%	11.3 Mw
E. Net *Firm* Capacity Available to Meet the Load (C − D)	376.9 Mw
F. Purchase Power of NP&L from TVA	50.4 Mw
G. Losses on F above (assumed 5%)	2.5 Mw
H. Total Net *Firm* Capability Available at Generation to Meet the System Requirements of NP&L and Tapoco (E + F + G)	429.8 Mw

Nantahala's peak load during the test year was 105,747 kw, which figure represents its maximum need during the year. Nantahala's demand responsibility for costing purposes was then calculated by dividing the total Nantahala-Tapoco system demand responsibility into Nantahala's maximum demand responsibility. Dividing 429,800 kw into 105,747 kw produces a Nantahala demand allocation of 24.60% of the system's demand responsibility. Using this allocation factor, the Commission assigned 24.60% of the Nantahala-Tapoco unified system demand costs to Nantahala and the balance to Tapoco (Alcoa).

While demand charge allocations must be computed based upon production capacity and capacity needs, energy charge allocations must be computed based upon the average energy available for the Nantahala-Tapoco unified system plus Nantahala's separate purchases from TVA. The data accepted by the Commission as appropriate for use in the allocation of energy related costs is as follows:

A. Average Energy Available from NP&L Projects (New Fontana Agreement Apportionment Study)	391,500 Mwh
B. Average Energy Available from Tapoco's Projects (New Fontana Agreement Apportionment Study)	1,373,600 Mwh
C. Total Average Energy Available from NP&L and Tapoco's Projects (A + B)	1,765,100 Mwh
D. NP&L Purchase of Energy from TVA	81,265 Mwh
E. Losses on D above (assumed 5%)	4,063 Mwh
F. Total Average Energy Available to Meet System Load (C + D + E)	1,850,428 Mwh

Nantahala's energy requirement during the 1975 test year was 453,548 mwh. Nantahala's energy responsibility for costing purposes was then calculated by dividing the total Nantahala-Tapoco system energy responsibility into Nantahala's energy responsibility. Dividing 1,850,428 mwh into 453,548 mwh produces a Nantahala energy responsibility of 24.51%. Using this allocation factor, the Commission assigned 24.51% of the Nantahala-Tapoco unified energy costs to Nantahala and the balance to Tapoco (Alcoa).

The methods, procedures and results of the intervenors' jurisdictional cost allocation methodology were adopted by the Commission in all material respects for determining Nantahala's retail costs of service. The practical effect of basing Nantahala's costs on actual combined system capabilities and needs was a decrease in the percentage of costs associated with the NFA and 1971 Apportionment Agreement recoverable from Nantahala's retail rate payers. The other "costs" actually incurred by the

unified system under the agreements were effectively allocated for rate making purposes to the systems' industrial customer, Alcoa, on whose behalf the Commission determined they were incurred.

To summarize, this matter was remanded for the purpose of determining whether a roll-in methodology was appropriate for Nantahala and Tapoco. Having determined that it was, and having identified those total system costs related to the supply of energy and those related to the demand for energy, the Commission was left with the task of allocating the appropriate demand and energy costs as between the North Carolina and Tennessee jurisdictional customers. The Commission then adopted the technique of cost allocation proposed by the intervenors' witness Springs, and allocated 24.60% of the combined demand costs and 24.51% of the combined energy costs to Nantahala's cost of service. These Nantahala percentages are calculated upon the relative contributions and needs of Nantahala as part of a combined system and not upon how Nantahala and Tapoco share in the N Fontana Agreement entitlements under the 1971 Apportionm Agreement. Although those contracts limit and rearrange the system's "energy" and "demand" availability, they do not allocate "cost of service" percentages between the retail consumers of the combined system's power. The roll-in and allocation of total system costs merely allowed the Commission to assign customer cost responsibility on the features of the actual system and not the system as reshaped by the New Fontana Agreement. The method does not ignore or alter the results of that agreement, it determines who is to bear the responsibility for the costs associated with the facilities and resources obligated thereunder. Having decided that Alcoa in negotiating the NFA effectuated a trade-off of dependable hydro capacity in return for improving the availability of energy for aluminum production, the Commission concluded that the aluminum production load should be assigned the responsibility for the investment costs and operation and maintenance expenses of the generating facilities for that traded capacity.

As the Commission stated in its order, one of the purposes for the roll-in method of rate making is to "cancel" or at least to "true up" the concealed benefits it found flowing to Alcoa under the power supply agreements. This is but another way of stating

that one purpose of the roll-in is to assign the appropriate cost responsibility for the respective customer demands upon the combined system's power supply resources. Obviously, use of the entitlements contained in these agreements, which do not reflect the investment costs and operation and maintenance expenses of the generating facilities upon which customer cost responsibility must be calculated, to then allocate costs would defeat the very purpose of the roll-in.

Moreover, as Nantahala itself recognizes in its brief, "the 1971 Apportionment Agreement is premised on the fact that Nantahala and Tapoco are separate entities and that the entitlements allocated to Nantahala *are deemed to arise* in exchange for Nantahala's generation just as the entitlements allocated to Tapoco *are deemed to arise* in exchange for Tapoco's generation." (Emphasis added.) The Commission, in rejecting the fiction that Nantahala and Tapoco were developed, designed and operated as separate corporate entities, also rejected the fiction that return entitlements *deemed to arise* in exchange for the value of the generation turned over to TVA can be used as accurate measures of the demand and energy related costs fairly attributable to Nantahala's provision of service to its retail rate payers.

It was the position of the intervenors' expert witness that the system-wide trade-off of costs and benefits under the NFA and 1971 Apportionment Agreement was detrimental to Nantahala's ability to provide service at just and reasonable rates to its public customers and unfairly shifted costs within the system to Nantahala which are properly attributable to Alcoa. Based upon substantial evidence of record, the Commission adopted this position and the roll-in technique proposed to measure and assign customer cost responsibility for the combined system's hydroelectric resources. The roll-in technique chosen by the Commission is fully supported by substantial evidence of record and is a determination which essentially rests within the discretion of the Commission in the exercise of its rate making function. As the United States Supreme Court has observed in reviewing a similar regulatory question, "judgment and discretion control both the separation of property and the allocation of costs when it is sought to reduce to its component parts a [utility] business which functions as an integrated whole." *Colorado Interstate Gas Co. v. FPC*, 324 U.S. at 591, 89 L.Ed. at 1217.

The companies do not argue, nor do we find, any error in judgment or abuse of discretion in the action of the Commission in the Sub 29 (Remanded) proceedings regarding the mechanics of the roll-in or the allocation formula utilized. Briefly stated, the principal arguments advanced by the companies are that the roll-in was impermissible under the doctrine of federal preemption because the two principal power supply contracts at issue are regulated by the FERC and that federal law prohibits the results obtained by the Commission under the roll-in as an undue burden on interstate commerce. We turn next to these and other remaining arguments of the companies concerning the order appealed from.

II.

A.

The New Fontana Agreement and its predecessor, the Original Fontana Agreement, effectuate power exchanges between Nantahala, Tapoco and TVA falling within the regulatory jurisdiction of the FERC under Part II of the Federal Power Act. Sections 205 and 206 of the Act, 16 U.S.C. §§ 824d and 824e, give FERC the authority to regulate wholesale rate schedules for the sale of electricity in interstate commerce. As we have seen, the OFA was never filed with FERC's predecessor, the FPC, as a tariff or rate schedule and the FPC never ruled upon the substantive terms of that agreement. The NFA was filed with the FPC "under protest" by Tapoco and Nantahala in response to the FPC's request that the companies do so. The NFA was formally designated "Tapoco Rate Schedule No. 3" and "Nantahala Rate Schedule No. 1" in 1966. No substantive review of its terms was undertaken by the FPC until Nantahala's wholesale customers raised the matter in 1978. The 1971 Apportionment Agreement, a contract affecting rates and charges under the Act, was not filed with the FPC until 1980, in conjunction with the foregoing complaint by Nantahala's customers. The contract was then designated as "Supplement 2 to Tapoco Schedule 3" and as a "Supplement to Nantahala Schedule No. 1." Again, substantive review of the operative effect of this agreement upon Nantahala's wholesale rates was not undertaken by FERC until 1980.

[7] Now, at the close of a forty year period marked by an "apparent determination never willingly to submit any of its hydro

projects to the duly enacted requirements of Federal law," 2 F.P.C. at 390, Nantahala and Alcoa argue, in effect, that FERC's exclusive jurisdiction to regulate interstate wholesale power transactions and to set wholesale rates preempts the North Carolina Utilities Commission from implementing a jurisdictional cost allocation formula which fails to utilize the proportion of NFA demand and energy entitlements allocated to Nantahala under the 1971 Apportionment Agreement in determining Nantahala's retail costs of service. Before addressing the separate and specific contentions of the companies, we will briefly review the legal and regulatory framework under which these issues arise.

1.

The doctrine of preemption is based upon the Supremacy Clause of the United States Constitution. U.S. Const., art. VI, cl. 2. When Congress legislates in an area within the federal domain, it may, if it chooses, take for itself all regulatory authority over the subject, share the task with the states, or adopt as federal policy the state scheme of regulation. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 91 L.Ed. 1447 (1947). The question in each case is the intent of Congress. *Id.* As the United States Supreme Court recently observed, "[m]aintaining the proper balance between federal and state authority in the regulation of electric and other energy utilities has long been a serious challenge to both judicial and congressional wisdom. On the one hand, regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States. . . . On the other hand, the production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests." (Citations omitted.) *Arkansas Elec. Coop. Corp. v. Arkansas Public Serv. Comm.*, 461 U.S. 375, 377, 76 L.Ed. 2d 1, 6 (1983). The Federal Water Power Act, now Part I of the Federal Power Act, 16 U.S.C. §§ 791a-823a, was enacted by Congress under its Commerce Clause powers in 1920. *New England Power Co. v. New Hampshire*, 455 U.S. 331, 340, 71 L.Ed. 2d 188, 196 (1982). The potential of water power as a source of electric energy led Congress to exercise its constitutional authority over navigable streams to regulate and encourage development of hydroelec-

tric power generation "to meet the needs of an expanding economy." *Id.* at 340, 71 L.Ed. 2d at 196, *quoting FPC v. Union Electric Co.*, 381 U.S. 90, 99, 14 L.Ed. 2d 239, 246 (1965).

Part II of the Federal Power Act, 16 U.S.C. §§ 824-824k, was enacted by Congress in 1935 as a "direct result" of the Supreme Court's holding in *Public Utilities Comm'n v. Attleboro Steam & Electric Co.*, 273 U.S. 83, 71 L.Ed. 54 (1927) that the states lacked power to regulate the rates governing interstate sales of electricity for resale. It delegated to the FPC, now the FERC, exclusive authority to regulate the transmission and sale at wholesale of electric energy in interstate commerce, without regard to source of production. *New England Power Co. v. New Hampshire*, 455 U.S. 331, 71 L.Ed. 2d 188. This portion of the Act was intended to "fill the gap" created by *Attleboro* with the establishment of exclusive federal jurisdiction over such sales. *Id.*

> What Congress did was to adopt the test developed in the *Attleboro* line which denied state power to regulate a sale "at wholesale to local distributing companies" and allowed state regulation of a sale at "local retail rates to ultimate consumers."
>
> * * *
>
> . . . Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction making unnecessary . . . case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States.

FPC v. Southern Cal. Edison Co., 376 U.S. 205, 214, 215-16, 11 L.Ed. 2d 638, *reh. denied*, 377 U.S. 913, 12 L.Ed. 2d 183 (1964), *quoting Illinois Natural Gas Co. v. Central Illinois Pub. Serv. Co.*, 314 U.S. 498, 504, 86 L.Ed. 371, 375 (1942).

Exclusive federal jurisdiction in setting wholesale power rates was thought necessary because concurrent, conflicting state regulation "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Chicago and N.W. Transp. Co. v. Kaylo Brick & Tile Co.*, 450 U.S. 311, 317, 67 L.Ed. 2d 258, 265 (1981). A state's independent assessment of

wholesale, interstate rates "could seriously impair the Federal Commission's authority to regulate a field over which Congress has given the Federal Power Commission [FERC] paramount and exclusive authority." *Northern Gas Co. v. Kansas Comm'n*, 372 U.S. 84, 92, 9 L.Ed. 2d 601, 608 (1963).

[8] Thus, FERC is prohibited from regulating intrastate retail rates charged to ultimate consumers and the states are prohibited from regulating interstate wholesale rates charged to local distributing companies. The result is a blend of federal-state regulation, each body with exclusive authority in its respective field. *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A. 2d 1358 (1977), *cert. denied*, 435 U.S. 972, 56 L.Ed. 2d 63 (1978); *Public Serv. Co. of Colo. v. Public Utils. Comm'n of Colo.*, 644 P. 2d 933 (Colo. 1982).

[9] Wholesale rates charged under the Federal Power Act must be "just and reasonable." 16 U.S.C. § 824d(a). Utilities regulated by the act are required to file rate schedules with the FERC, which has authority to investigate and modify new schedules. 16 U.S.C. § 624d(b) and (d). As a result of FERC's exclusive power to establish reasonable rates for utilities subject to its jurisdiction, a utility subject to FERC jurisdiction "can claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the [FERC], and not even a court can authorize commerce in the commodity on other terms. [T]he right to a reasonable rate is the right to the rate which the [FERC] files or fixes. . . ." *Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251, 95 L.Ed. 912, 919 (1951). Thus, the North Carolina Utilities Commission is preempted from directly or indirectly regulating the wholesale rate structure created by the New Fontana and 1971 Apportionment Agreements or inquiring into the reasonableness of those FERC-filed wholesale rate schedules when it acts in fixing Nantahala's retail rates.

Nantahala and Alcoa present a number of overlapping and somewhat confused arguments regarding their contention that the doctrine of federal preemption stands as a bar to the Commission's order. It appears, however, that in essence both Nantahala and Alcoa argue that the Commission has directly interfered with FERC's exclusive and paramount jurisdiction over the NFA and 1971 Apportionment Agreement by reviewing the reasonableness

of these contracts and has indirectly intruded upon that jurisdiction by disregarding or altering the level of costs and expenses attributed to Nantahala as if it were a stand-alone company under these contracts. We disagree.

With respect to the former argument, it is clear that the Commission's examination of the NFA and 1971 Apportionment Agreement was not undertaken in an effort to either establish wholesale rates or to modify agreements filed with and approved by the FERC. In its order reducing rates the Commission expressly rejected the remedy of reforming these agreements to award Nantahala its just level of entitlements and nothing contained in the Commission's order purports to change or modify a single word of the several contracts or agreements involved, or the actual flow of power thereunder.

The companies rely heavily upon the holdings in *Attleboro* and *Southern California Edison* to challenge the authority of the Commission to implement the roll-in methodology proposed by the intervenors. We find that reliance to be misplaced. In each of those cases the dispositive fact under the doctrine of federal preemption was the state commission's specific modification of a contract establishing a wholesale rate. In the instant case, neither the contracts themselves nor the wholesale rates fixed thereunder were changed by the Commission in its order. The roll-in was used solely to determine the unified rate base, operating costs and revenues of Nantahala and Tapoco and to allocate jurisdictional costs of service in the process of fixing Nantahala's retail rates to its North Carolina consumers. *Attleboro* and *Southern California Edison* confirm, rather than deny, the propriety of state regulation of retail electric power rates.

Nor are we persuaded by the companies' arguments that the Commission has indirectly intruded upon the federal regulatory domain by disallowing or altering the interstate wholesale costs and expenses borne by Nantahala under the NFA and the 1971 Apportionment Agreement. Rather, we find the Commission's treatment of those wholesale costs to be well within the field of exclusive state rate making authority engendered by the "bright line" between state and federal regulatory jurisdiction under the Federal Power Act.

The Utilities Commission is the administrative agency charged with the duty of regulating the intrastate retail rates of public utilities within the State of North Carolina. N.C.G.S. § 62-32. Under N.C.G.S. Chapter 62, the Commission is authorized to conduct hearings to investigate the propriety of proposed rate changes and to make such orders with regard to the proposed rate as may be just and reasonable. In fixing rates under N.C.G.S. § 62-133, the Commission must fix such rates "as shall be fair to both the public utility and to the consumer." N.C.G.S. § 62-133(a). The basic theory of utility rate making pursuant to that statute is that rates should be fixed at a level which will recover the cost of service to which the rate is applied, plus a fair return to the utility. *Utilities Comm. v. Edmisten, Atty. General,* 291 N.C. 451, 232 S.E. 2d 184 (1977). This provision of Chapter 62 lays down the procedure by which the Commission is to fix rates "which will enable the utility 'by sound management' to pay all of its costs of operation, including maintenance, depreciation and taxes, and have left a fair return upon the fair value of its properties." *Utilities Comm. v. Telephone Co.,* 285 N.C. 671, 680-81, 208 S.E. 2d 681, 687 (1974). However, the primary purpose of Chapter 62 is to assure the public of adequate service at a reasonable charge; the provisions of this Chapter designed to assure the utility of adequate revenues are in the nature of corollaries to the basic proposition that the public is entitled to adequate service at reasonable rates. In addition such "corollaries" act as safeguards against arbitrary and unconstitutional administrative action. *Id.*

N.C.G.S. § 62-133 prescribes the formula which the Commission is required to follow in fixing rates for service to be charged by any public utility in pertinent part as follows:

> (b) In fixing such rates, the Commission shall:
>
> (1) Ascertain the reasonable original cost of the public utility's *property used and useful . . . in providing the service rendered to the public within* this State. . . .
>
> * * *
>
> (3) Ascertain such public utility's reasonable operating expenses, including actual investment currently consumed through reasonable actual depreciation. (Emphasis added.)

The fair value of the property described in paragraph (b)(1) is the rate base. Additionally, paragraph (c) of this statute allows the consideration of evidence of changes in costs, revenues, or the cost of the public utility's property used and useful "in providing the service rendered to the public within this State," within a reasonable time after the test period.

[10] Clearly, the statute limits the property upon which the North Carolina consumers are required to pay a return to the property used and useful in providing *intrastate* service. When the provisions of N.C.G.S. § 62-133(b)(1), (b)(3) and (c) are read *in pari materia, see Utilities Commission v. Duke Power Co.*, 305 N.C. 1, 287 S.E. 2d 786 (1982), it is apparent that the only operating expenses which the Commission may consider in setting intrastate rates for North Carolina public utilities are those incurred in the provision of service to the utility's North Carolina consumers. *See, e.g., Utilities Comm. v. Edmisten, Attorney General*, 291 N.C. 424, 430, 230 S.E. 2d 647, 651 (1976) (system-wide cost of service study which significantly varied from results produced by a study based solely on North Carolina data would be incompetent since, "North Carolina rates may not be structured by external system usage"); *Utilities Comm. v. Telephone Co.*, 281 N.C. 318, 366, 189 S.E. 2d 705, 751 (1972) ("'North Carolina users of telephones are not to be required to furnish revenue to maintain applicant's financial condition which other states refuse to provide'"); *Utilities Commission v. State of North Carolina*, 239 N.C. 333, 345-46, 80 S.E. 2d 133, 141 (1954) ("Strictly speaking what is the fair value of applicant's investment in its intrastate business in this State and what constitutes a fair return thereon are the primary questions before the Commission for decision"). Accordingly, jurisdictional cost allocation is a necessary step in any general rate case involving a public utility or utility system whose separate companies are operated as a single enterprise serving both jurisdictional (intrastate retail) and non-jurisdictional consumers. *See also Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 89 L.Ed. 1206.

[11] Additionally, in construing the provisions of N.C.G.S. § 62-133, the Commission must also consider section (d) of that statute, which provides that the "Commission shall consider all other material facts of record that will enable it to determine what are reasonable and just rates." N.C.G.S. § 62-133(d) has been

construed as a device permitting the Commission to take action consistent with the overall command of the general rate statutes, but not specifically mentioned in those portions of the statute under consideration in a given case. *See, e.g., Utilities Commission v. Duke Power Co.*, 305 N.C. 1, 287 S.E. 2d 786 (Commission correctly considered non-statutory material factor concerning depreciation expenses in determining what are reasonable and just rates pursuant to N.C.G.S. § 62-133(d)). *See also Utilities Commission v. Public Staff*, 58 N.C. App. 453, 293 S.E. 2d 888 (1982), *modified and affirmed*, 309 N.C. 195, 306 S.E. 2d 435 (1983) (Commission must take other factors such as the efficiency of the company's operations into account in fixing its rates in a general rate case). In sum, the fixing of "reasonable and just" rates involves a balancing of shareholder and consumer interests. The Commission must therefore set rates which will protect both the right of the public utility to earn a fair rate of return for its shareholders and ensure its financial integrity, while also protecting the right of the utility's intrastate customers to pay a retail rate which reasonably and fairly reflects the cost of service rendered on their behalf.

[12, 13] The fundamental question as to whether certain expenditures are to be included in the operating expenses a utility is entitled to collect from its customers is one of fact to be ascertained by the regulating authority. *See generally*, 1 Priest, *Principles of Public Utility Regulation* 45 (1969). "If properly incurred, they must be allowed as part of the composition of the rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above expenses, would be a farce." *Mississippi River Fuel Corp. v. FPC*, 163 F. 2d 433, 437 (1947). *Accord Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A. 2d 1358. As a corollary to the foregoing proposition, it is also true that ordinarily, the Commission may, in a proper case, refuse to allow the utility to include in its reasonable operating expenses, the full price it actually paid for power as a result of its contractual power supply arrangements. *Utilities Comm. v. Intervenor Residents*, 305 N.C. 62, 286 S.E. 2d 770 (1982). This is especially so where the operating expense being investigated by the Commission is one incurred through a contract between or including the utility company and its affiliated companies, including parent corporations and subsidiaries of parent corporations. *Id.* In such

cases the burden of persuasion on the issue of reasonableness always rests with the utility; charges arising out of intercompany relationships between affiliated companies should be scrutinized with care and may be properly refused or disallowed in the absence of a showing of their reasonableness. *Id.*; *Utilities Comm. v. Telephone Co.*, 281 N.C. 318, 189 S.E. 2d 705.

[14] A major operating expense which the Commission must necessarily consider in arriving at reasonable and just rates for Nantahala is the "cost" of power Nantahala incurs under the power supply agreements with its affiliates and TVA. However, the Commission's otherwise plenary authority to investigate transactions between a public utility and its affiliated companies, and to disallow operating expenses found to be imprudently incurred or allocated under such agreements, is limited by prior federal approval of the rate or price in question under the "filed rate" doctrine of *Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 95 L.Ed. 912. There, the United States Supreme Court stated:

> We hold that the right to a reasonable rate is the right to the rate which the Commission files or fixes, and that, except for review of the Commission's orders, the courts can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable.

Id. at 251-52, 95 L.Ed. at 919. Thus, neither the state public service commission nor the courts can unilaterally establish a different rate for wholesale electric power sold in interstate commerce because they are of the opinion that the FERC-filed or approved rate is unfair or unreasonable. *See Public Serv. Co. of Colo. v. Public Utils. Comm'n of Colo.*, 644 P. 2d 933.

Those state courts which have considered the question have uniformly agreed that a utility's costs based upon a FERC-filed rate must be treated as a reasonably incurred operating expense for the purposes of setting an appropriate retail rate. *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A. 2d 1358; *Public Serv. Co. of Colo. v. Public Utils. Comm'n of Colo.*, 644 P. 2d 933; *United Gas Corp. v. Mississippi Pub. Serv. Comm'n*, 240 Miss. 405, 127 So. 2d 404 (1961); *City of Chicago v. Illinois Commerce Comm'n*, 13 Ill. 2d 607, 150 N.E. 2d 776 (1958); *Citizen Gas Users Ass'n v. Public Util. Comm'n*, 165 Ohio St. 536, 138 N.E. 2d

383 (1956); *Eastern Edison Co. v. Dept. of Public Util.*, 388 Mass. 292, 446 N.E. 2d 684 (1983); *Pike Cty. Light & Power v. Pennsylvania*, 465 A. 2d 735 (Pa. Cmwlth. 1983); *Washington Gas Light Co. v. Public Serv. Comm'n*, 452 A. 2d 375 (D.C. App. 1982), *cert. denied*, 462 U.S. 1107, 77 L.Ed. 2d 1334 (1983). "Otherwise, a State utilities commission could review the reasonableness of the FERC-filed wholesale rate in a proceeding establishing retail rates, in violation of the Federal Power Act." *Eastern Edison Co. v. Dept. of Public Util.*, 388 Mass. at 300, 446 N.E. 2d at 689; *Northern States Power Co. v. Minnesota P.U.C.*, 344 N.W. 2d 374 (Minn.), *cert. denied*, *Humphrey v. North States Power Co.*, --- U.S. ---, 82 L.Ed. 2d 850 (1984); *Northern States Power Co. v. Hagen*, 314 N.W. 2d 32 (N.D. 1981); *Office of Public Counsellor v. Indiana & Michigan Electric Co.*, 416 N.E. 2d 161 (Ind. App. 1961). *See also Northern Gas Co. v. Kansas Comm'n*, 372 U.S. 84, 9 L.Ed. 2d 601. *See generally*, 16 A.L.R. 4th 454, § 3(b).

Nantahala and Alcoa rely heavily upon the foregoing line of cases in support of their arguments that the utilization of the roll-in in the instant case violates the Supremacy Clause of the United States Constitution because it is inconsistent with federal jurisdiction over the NFA and the 1971 Apportionment Agreement. The companies contend, in effect, that the Commission's failure to base Nantahala's demand and energy related costs on the quantity and design of entitlements assigned to Nantahala on a stand-alone basis under these agreements is tantamount to a disallowance of costs actually borne by Nantahala and as such constitutes an impermissible, indirect intrusion into the federal regulatory domain. We reject the companies' various federal preemption arguments for two reasons: (1) their reliance upon the *"Narragansett-Northern States"* line of authority to establish a Supremacy Clause violation is misplaced and (2) their arguments rest upon the faulty premise that FERC deemed both the NFA and the 1971 Apportionment Agreement to be fair and reasonable to Nantahala, when in fact it expressly ruled that the latter agreement was "unfair" and refused to permit Nantahala to base its requested wholesale rate increase upon the costs incurred thereunder.

The rule requiring state commissions to "treat" costs based upon FERC-filed rates as reasonably incurred operating expenses, thus preventing the automatic disallowance of these costs, has not

been held to preclude state authority to determine whether these costs should be automatically passed through to retail consumers in the form of higher rates. For example, in the *Narragansett* case itself, the Rhode Island Supreme Court concluded that although the state utilities commission had to consider the cost of electricity to the local distributing company based upon its supplier's federally filed wholesale rate as an actual operating expense, it was not required to adjust Narragansett's retail rates to reflect the increased wholesale costs under its PPCA (Purchased Power Cost Adjustment) provisions. The court reasoned that in view of the state utilities commission's broad discretion over the operation of the PPCA under the applicable state statutes and the PPCA provisions, the commission was free to "treat the proposed rate increase as it treats other filings for charged rates under [state statute] and investigate the overall financial structure of Narragansett to determine whether the company has experienced savings in other areas which might offset the increased price for power." 119 R.I. at 568, 381 A. 2d at 1363.

The Colorado Public Utilities Commission and the Colorado Supreme Court have stated even more explicitly that state commissions have the authority to determine that certain FERC-regulated wholesale costs are not incurred for the benefit of retail customers and therefore need not be passed on to retail customers in their rate schedules. *In Re Western Slope Gas Co.*, 31 P.U.R. 4th 93 (Colo. PUC 1979), *aff'd, Public Serv. Co. of Colo. v. Public Utils. Comm'n of Colo.*, 644 P. 2d 933, a natural gas utility sought to pass through the costs of its wholesale gas purchases in retail rates by means of purchased gas adjustment clauses. These costs, including surcharges to cover expenses of the Gas Research Institute ("GRI"), a research and development firm supported by the natural gas industry, were regulated by FERC. The Colorado Commission conceded that it was obligated to treat these costs as reasonably incurred operating expenses. However, the commission refused to allow the costs to be flowed through automatically to retail customers, stating that under *Narragansett*, it was free to determine whether those costs should be reflected in retail rates. 31 P.U.R. 4th at 107. The Colorado commission questioned the propriety of forcing retail customers to bear the expense due to their inability to exercise control over the expenditure of GRI

funds and because most of the benefits would flow to the gas utilities themselves and to other related private interests.

The Colorado Supreme Court upheld the commission's decision that these GRI expenses need not be passed through automatically to consumers. The court concluded that although FERC-regulated GRI expenses must be treated as reasonable and prudent operating expenses, the state commission had the authority to scrutinize such costs in a general rate case "to balance the interests of the utility investors and the ultimate consumers in arriving at a just and reasonable rate. . . ." 644 P. 2d at 941. The Colorado Supreme Court specifically recognized the Colorado commission's concern that GRI costs benefit a utility and its shareholders far more than the utility's customers. *Id.* at 941, n. 10. The court concluded its opinion by stating, "[s]o long as the PUC considers the GRI adjustment charge as a reasonably incurred operating expense of a local distribution company, as it is legally required to do, its decision to refrain from automatically passing such charges on to the ultimate consumers falls within its administrative discretion." *Id.* at 942.

In *Washington Gas Light Co. v. Public Serv. Comm'n*, 452 A. 2d 375, the District of Columbia Court of Appeals faced the same question considered in *Public Serv. Co. of Colorado*. That is, whether increases including GRI expenses reflected in a utility's FERC-regulated wholesale gas costs should be passed through to retail customers in the form of a rate increase. The local commission had disallowed the increased GRI charges as reasonable operating expenses on the grounds that FERC's authority to approve these charges was the subject of an appeal pending at the time of the commission's decision and so the costs attributed thereto were not a "measurable and certain expense." 452 A. 2d at 385. The court reversed the commission's refusal to allow the increased GRI charges to be reflected in retail rates based upon its own independent inquiry into the reasonableness of the GRI charges on the grounds that the commission was without authority to disregard a FERC order which had not been stayed during proceedings for review and was therefore in full force and effect. *Id.* at 386.

However, in the course of its discussion, the court made it quite clear that it remained within the local commission's authori-

ty to determine that the expenses should not automatically be passed through to retail customers.

> FERC's jurisdiction [does not extend] to the issue of whether increased wholesale costs shall be passed through to retail customers by the local utility. The determination of the extent to which wholesale costs should be reflected in local utility rates lies exclusively with local utility commissions. *See* [*Narragansett*].

Id. at 385, n. 15. *Accord Pike Cty. Light & Power v. Pennsylvania*, 465 A. 2d 735, 738 (FERC's jurisdiction extends to the setting of rates for out-of-state parent utility to charge local electric utility at wholesale; however, state utility commission has exclusive jurisdiction, as a matter of retail rate making, to determine whether it was just and reasonable for local utility to incur the parent's rates and charges as an expense of operation in light of available alternatives); *Kansas-Nebraska Natural Gas Co., Inc. v. State Corporation Commission*, 4 Kan. App. 2d 674, 610 P. 2d 121 (1980) (FERC's regulation of an advance payment contract with an affiliate does not preclude state public service commission's scrutiny of the agreement to determine, not whether the agreement was reasonable, but whether it was *required* for service to the local rate payers). *See also Eastern Edison Co. v. Dept. of Public Util.*, 388 Mass. 292, 446 N.E. 2d 684 (*Narragansett* and *Public Service Co. of Colorado* discussed with approval although holdings distinguished on the grounds that the Massachusetts statutes require automatic flow-through of all reasonably incurred fuel and purchased power expenses; Massachusetts commission had no authority to consider factors other than the companies' fuel costs).

Thus, several cases in the *Narragansett* line expressly recognize that a state commission retains the discretion to do exactly what the Commission has done in the instant case: determine that certain of a utility's costs were effectively incurred for the benefit of its shareholder, not its retail consumers, and therefore should be borne by the shareholder, and not by the utility's retail rate payers. The cases upon which Nantahala and Alcoa place principal reliance, *Northern States Power Co. v. Hagen*, 314 N.W. 2d 32, the related case of *Northern States Power Co. v. Minnesota P.U.C.*, 344 N.W. 2d 374, and *Office of*

Public Counsellor v. Indiana and Michigan Electric Co., 416 N.E. 2d 161, do not lead to a different conclusion.

Both *Northern States* cases involved an agreement which allocated losses incurred by an interstate utility enterprise operating in Minnesota and Wisconsin, when the Tyrone Nuclear Power Project (to be located in Wisconsin) was abandoned. The parties to the agreement, Northern States Power (NSP), a Minnesota corporation, and its wholly-owned subsidiary, Northern States Power-Wisconsin (NSP-W), a Wisconsin corporation, served, respectively, electric customers in four states, with NSP serving Minnesota, North Dakota and South Dakota and NSP-W serving only Wisconsin. Although NSP and NSP-W both originally owned an interest in Tyrone, NSP transferred its share in the project to NSP-W to comply with Wisconsin law. The transfer did not effect any change in the planned use of the project to serve the single system's various customers. NSP and NSP-W operated under the aforementioned Coordinating Agreement (CA), filed with FERC, by which they shared the total system cost of power generation in a ratio roughly proportionate to the ultimate use by the customers of each. The companies filed an amendment to the CA which was designed to allocate Tyrone abandonment costs under the same allocation formula by which the companies' wholesale rates are computed. FERC ultimately approved the amendment to the CA. Thereafter, NSP sought to "pass through" the Tyrone losses to its retail rate payers in its respective service areas, claiming that FERC's approval of the amended CA resulted in the establishment of an interstate wholesale rate which state commissions were preempted from reviewing for the purpose of retail rate making. However, both the North Dakota Public Service Commission and the Minnesota Public Utilities Commission rejected NSP's arguments that FERC approval of the amended CA automatically required the state commissions to allow NSP to treat its share of the Tyrone losses as a reasonable operating expense to be borne by NSP's North Dakota and Minnesota retail rate payers. The supreme courts of both states reversed the orders of their respective state commissions disallowing the Tyrone-related costs on the ground that the reasonableness of a formula wholesale rate filed and approved by FERC cannot be relitigated in a retail rate proceeding before a state utilities commission.

In *Northern States Power Co. v. Hagen*, the North Dakota court noted that NSP is required by the FERC order to pay a fixed wholesale rate for electricity to NSP-W which includes the amortization of the Tyrone losses. 314 N.W. 2d at 37. The court reasoned that since the North Dakota Public Service Commission had no direct jurisdiction over the interstate wholesale rates, "it would undermine the supremacy clause and the preemption doctrine for the PSC to indirectly assert jurisdiction over the wholesale rates by investigating the reasonableness of underlying [wholesale] costs in a proceeding involving retail rates." *Id.* at 38. The court concluded by stating that for purposes of fixing intrastate rates, the PSC must treat costs incurred under NSP's filed interstate wholesale rates as reasonable operating expenses. The Supreme Court of Minnesota, when faced with the identical question in *Northern States Power Co. v. Minnesota P.U.C.*, came to the identical conclusion and held that the Minnesota Public Utilities Commission was required to treat the Tyrone-related costs incurred under the FERC-approved wholesale rate formula as expenses for power purchased in determining retail rates. 344 N.W. 2d at 382.

It is thus evident that the *Northern States* cases are clearly distinguishable from the instant case in that they both involved the direct disallowance by the respective state commissions of wholesale costs approved by FERC in the exercise of its exclusive rate making authority. As we have previously stated, the Commission did not disallow any of the system costs incurred by both Nantahala and Tapoco under the NFA and 1971 Apportionment Agreement in determining the aggregate rate base and operating expenses of the rolled-in system. Rather, *all costs* attributed to Nantahala and Tapoco were *recognized and allowed* by the roll-in; the difference between "book" costs and "reasonable" costs resulting from the Commission's discretionary determination that only a certain percentage of Nantahala's book costs were incurred in serving the combined system's intrastate retail customers.

For similar reasons, we find the companies' reliance upon *Office of Public Counsellor v. Indiana & Michigan Electric Co.* to be misplaced. Again, the challenged action by the state public service commission in that case was the disallowance of a particular purchased power expense incurred by the local Indiana utility, Indiana & Michigan Electric Co. (I&M), under an interstate,

wholesale power agreement with its wholly-owned subsidiary, Indiana & Michigan Power Co. (IMP). IMP's principal assets are two nuclear power production units located in Michigan. IMP's total output of electric power is sold to I&M pursuant to a FERC-regulated power agreement which provides that I&M is entitled to all of the energy generated by IMP units, and in return, I&M is obligated to compensate IMP for all costs of production and purchase power, including a return on equity. The Public Service Commission of Indiana determined that the property of the Michigan subsidiary was "used and useful" in serving the customers of the parent local utility and should therefore be included in its rate base.

In reversing that decision, the Indiana court placed great emphasis on the fact that the contract by which the parent purchased the electricity from the subsidiary, which was subject to the exclusive jurisdiction of the FERC, included a provision specifically allowing the subsidiary a return on its equity so that a "fair rate of return under the contract is computed by the FERC." *Office of Public Counsellor*, 416 N.E. 2d at 164. Thus, the court concluded that for the state commission to include the subsidiary's assets in the parent's rate base would permit the state commission to determine a cost of service and rate of return for the subsidiary *other than* the FERC established rate and would constitute an impermissible collateral attack on the authority of the FERC.

> The FERC and the Commission do not share concurrent jurisdiction with regard to the proper rate of return on IMP assets. Rather, the FERC has exclusive jurisdiction over the regulation of wholesale interstate power sales. Any attempt by the Commission to assign a rate of return attributable to IMP's cost of power clearly encroaches upon the FERC's duties and powers.

Id. at 165.

Nantahala relies on the Indiana decision in support of its argument that the Commission's "attempt to roll-together Nantahala and Tapoco and allocate a lower level of costs and expenses to Nantahala than Nantahala actually incurs under the NFA and 1971 Apportionment Agreement constitutes an intrusion upon FERC jurisdiction over those agreements, similar in

nature to the discredited 'roll-in' of I&M and IMP by the Indiana Commission." We do not agree. Again, the roll-in of Nantahala and Tapoco resulted in no disallowance or alteration of FERC-approved costs, expenses or rates of return. Nantahala's retail rates could be lowered because a lesser quantum of higher cost Nantahala energy has been averaged with a higher quantum of lower cost Tapoco energy. As a result, the average cost of roll-in energy is lower than the cost of Nantahala-only energy. Moreover, it is obvious that the "roll-in" attempted by the Indiana commission entailed a far more direct intrusion into FERC's regulatory domain in the form of a redetermination of the FERC-established rate of return for IMP's property, which fell exclusively under FERC's jurisdiction by the very terms of the interstate power agreement. Here, FERC has no authority, either exclusive or concurrent, to determine Nantahala's rate of return on its assets or the costs of service associated with providing Nantahala's intrastate retail customers with electricity. Rather, these determinations fall within the exclusive rate making jurisdiction of the North Carolina Utilities Commission.

Indeed, state commissions have been held to expressly retain, under the "filed rate" doctrine, the authority to decline to automatically reflect operating expenses incurred under FERC-regulated rate schedules or contracts in the structure of intrastate retail rates where, for example, the state commission determines (1) that increases in FERC-approved charges in one area of the utility's operations were not offset by economies in other areas (*Narragansett*); (2) that certain FERC-regulated costs were not, either in whole or in part, primarily incurred for the benefit of retail rate payers, but rather for the benefit of the utility's investors (*Public Serv. Co. of Colo.; Washington Gas Light Co.*); (3) that in light of available alternatives, certain FERC-approved expenses charged by a parent to the local utility were not reasonably attributable to the costs of serving local rate payers (*Pike Cty. Light & Power*); and (4) that certain FERC-regulated payments between parent and subsidiary were not required for service to the local rate payers (*Kansas-Nebraska Natural Gas Co.*).

In this case, the Commission, in carrying out its duty to determine what are reasonable and just rates for Nantahala's intrastate retail customers to pay for electric service, made a

searching examination of "all material facts of record," as it is required to do by N.C.G.S. § 62-133(d), including but not limited to, the effect of the FERC-filed power supply contracts on Nantahala's costs of service. It also considered the entire historical development of the Nantahala-Tapoco electric system and the intercorporate allocation of the costs and benefits associated therewith.

The Commission's extensive and detailed findings of fact taken as a whole effectively demonstrate that certain portions of the operating expenses Nantahala incurs under the NFA and 1971 Apportionment Agreement were not incurred for the benefit of Nantahala's retail rate payers, were not required for their service and were not offset by compensating economies or benefits in other areas of the utility's operations. In addition, the Commission determined that Nantahala's parent Alcoa, which is also the single largest customer of the combined system, had so dominated Nantahala that the utility was unable to act either in its own self-interest or in the interests of its public customers and that through its domination, Alcoa had received substantial concealed benefits, by means of the contractual and intercorporate structure of the "Alcoa power system," to the corresponding detriment of Nantahala's ability to render service at reasonable and just rates to its public customers. In this regard, the Commission determined that one of the most fundamental of the concealed benefits flowing to Alcoa under the NFA was the trading away of hydroelectric capacity suitable for serving a public load, at a time of sustained growth in that load, in return for entitlements structured to be of far more value for aluminum smelting than for public service.

Accordingly, the Commission determined that to the extent that Alcoa had caused Nantahala to trade capacity and energy suitable and usable for serving its public load, the costs associated with that trade-off would be borne by Alcoa and not by the retail rate payers who lost the benefit of these resources and facilities of Nantahala through intercorporate transactions over which they had no control. This determination lies well within the sphere of state regulatory authority delineated in the *Narragansett-Northern States* line of cases relied upon by the companies in support of their preemption arguments.

[15] Moreover, none of the cases relied upon by the companies dealt with the particular situation presented by the facts in this case. In effect, the Commission has recognized that two affiliated North Carolina public utilities, Nantahala and Tapoco, both of whom are controlled by their parent-customer Alcoa, itself a North Carolina statutory public utility, were in substance providing a joint service to retail customers in North Carolina, as well as to Alcoa, although the public service in North Carolina was labeled as service from Nantahala alone. By means of the roll-in, the Commission set the "Nantahala" retail rates by combining the financial data of the two affiliates into a unified rate base, and determined on a conventional load responsibility basis what portion of the rolled-in system's costs should be borne by the non-Alcoa customers, to produce the same billing rates as would result from an explicitly joint service at lawful, nondiscriminatory rates. Thus, it disregarded only the fiction of Tapoco as a separate utility system serving only Alcoa, in order to ensure that the joint Nantahala-Tapoco service to North Carolina retail customers was provided at just and reasonable rates. Insofar as the Commission determined that Alcoa as corporate parent and private industrial customer had benefited at the expense of the public load from the corporate and power supply arrangements it imposed upon its subsidiaries, it was well within its regulatory authority to decide that the costs associated with those benefits would not be borne by the public consumers in the form of higher retail rates, but would be borne by the company's customer and sole shareholder, Alcoa.

In practice, the Commission's roll-in methodology accepted Nantahala's and Tapoco's entitlements under the NFA and 1971 Apportionment Agreement, and Nantahala's supplementary purchases from TVA, as elements of the combined Nantahala-Tapoco cost of service. The Commission then determined that it was inappropriate to allow Nantahala to collect all of its revenue requirements from its public customers on the theory that it was a stand-alone company, because Nantahala's "stand-alone" costs under the corporate and contractual arrangements were not incurred for their benefit, but as a result of Alcoa's corporate dominance for Alcoa's benefit. The Commission's finding of Alcoa domination, to the extent it is based on findings of concealed benefits to Alcoa from the NFA and 1971 Apportionment Agreement, is not the same as a finding that those agreements were unjust and unreasonable as wholesale rate schedules or contracts affecting wholesale rates. Rather, it is a finding that to the extent that Alcoa, rather than Nantahala and its customers benefited from those agreements, Alcoa should bear the corresponding costs (the difference between Nantahala's actual retail collections and the costs that reasonably should be borne by its retail customers).

[16] In short, contrary to the companies' assertions, the "filed rate" doctrine does not require that the Commission, in determining the proper costs to Nantahala's retail customers for the service provided to them, use demand and energy factors based upon the proportion of entitlements allocated to Nantahala alone under the NFA and 1971 Apportionment Agreement. Thus, we are unpersuaded by the arguments of Nantahala and Alcoa that this action on the part of the Commission directly or indirectly interferes with FERC's exclusive regulatory authority under the Federal Power Act.

2.

We are equally unpersuaded that the order conflicts with specific FERC actions taken with respect to the NFA and 1971 Apportionment Agreement. In fact, we find the Commission's rate making methodology to be consistent with FERC's own actions in the parallel wholesale rate case, *Nantahala Power and Light Co.*, Opin. No. 139, 19 F.E.R.C. ¶ 61,152 (1982) and Opin. No. 139-A, 20 F.E.R.C. ¶ 61,430, *affirmed on appeal, Nantahala Power and Light Co. v. FERC*, 727 F. 2d 1342.

The consolidated proceeding before the FERC involved a 1976 rate increase request filed by Nantahala and a 1978 complaint filed pursuant to Section 306 of the Federal Power Act by three of Nantahala's wholesale customers. Nantahala sought an annual rate increase based upon the test period ending 31 December 1975, effective for the period of 1 October 1976 to 1 March 1981. The customers alleged that the three companies, Alcoa, Nantahala and Tapoco, were in violation of the Federal Power Act by diverting, for the benefit and private use of Alcoa, hydroelectric power and facilities dedicated to public service. The customers argued that Alcoa had used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act, that the corporate structure and

resulting power supply agreements were unfair to Nantahala, and that the situation could be remedied by either a roll-in of Nantahala and Tapoco or by reformation of the power supply agreements to reflect a more fair and reasonable allocation of power and energy to Nantahala. Although the Administrative Law Judge rejected the single entity theory of the customers, and therefore their proposed roll-in remedy, he expressly found that the allocation of entitlements to Nantahala under the 1971 Apportionment Agreement was unfair. *See* 15 F.E.R.C. ¶ 63,014.

The ALJ concluded that it would be unjust to require Nantahala's wholesale customers to bear their proportionate share of the purchased power costs associated with the 1971 Apportionment Agreement and the Nantahala-TVA supplemental purchase contract. Instead, he determined that the rates should be set *as if* the 1971 Agreement allocated the NFA entitlements in a manner proposed by the FERC staff. Inasmuch as the rates computed on this basis were lower than the rates charged on the basis of Nantahala's book costs under those agreements, Nantahala was ordered to refund its customers the extra revenue it had collected to pay for the unnecessary TVA purchases. The ALJ also determined that Nantahala's PPAC was unlawful and that the 1971 Apportionment Agreement was a contract affecting rates and charges under Section 205(c) of the Federal Power Act, which should have been filed when made. However, the ALJ declined to impose sanctions for Nantahala's failure to timely file the agreement.

In Opinion No. 139, the FERC affirmed the ALJ's order in all material respects. *Nantahala Power and Light Company*, 19 F.E.R.C. ¶ 61,152. Once again, examination of the relevant power transactions and power supply agreements was undertaken primarily to resolve the "central question [of] whether a preponderance of the evidence supports a finding that Alcoa has used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act." *Id.* at p. 61,276. Although the FERC answered the question thus posed in the negative, and therefore rejected the customers' related contention that the two companies operate as an integrated system whose rates should be determined on a rolled-in basis, it expressly recognized that the North Carolina Utilities Commission has and may reach a different conclusion under state law on both the

status of Tapoco as a North Carolina public utility, *id.* at p. 61,277, n. 21, and on the question of rolled-in costing, *see* 20 F.E.R.C. ¶ 61.430.[21]

The FERC briefly examined the circumstances surrounding the OFA and the NFA and concluded that the two agreements were the result of "arms length bargaining" and that "[t]he above history of the OFA and NFA indicates no intent on the part of any of the parties to ignore the needs of Nantahala's public service customers or deprive them of energy at just and reasonable rates." 19 F.E.R.C. ¶ 61,152 at p. 61,278. Continuing, the FERC stated: "The apportionment agreements are another matter. . . . *The alleged fairness of the 1971 Agreement is not supported by the record.* The 1963 Agreement gave Nantahala considerably greater benefits than does the 1971 Agreement, and there is no indication in the record as to why Nantahala, without consideration, gave up those benefits." *Id.* at pp. 61,278-79. (Emphasis added.)

In affirming the decision of the ALJ, the FERC determined that Nantahala should have received a greater share of the NFA entitlements and that a disproportionate share had been assigned to Tapoco. To remedy this inequity for rate making purposes, FERC adopted the staff's calculation of a fair share of entitlements for Nantahala based upon its actual relative contribution to the total net combined generation of the two companies' plants which is turned over to TVA under the NFA (22.50%) and then determined that Nantahala should have received 22.50% (or 404 million) of the 1,800 million kwh under the 1971 Apportionment Agreement. Since Nantahala had received only 360 million kwh under the 1971 Agreement, FERC reasoned that Nantahala had purchased from TVA 44 million kwh of energy more than it should have, and that these excessive purchases should not have been reflected in Nantahala's wholesale rates. Therefore, the FERC ordered that "Nantahala shall be required to refund, with interest, any amounts collected in excess of those which would

21. In its order denying rehearing (Opinion No. 139-A), FERC stated: "We recognize that the North Carolina Utilities Commission (NCUC), based on a similar record, reached a different conclusion concerning rolled-in costing. However, the question of whether to treat various entities as an integrated system for rate making purposes is not a purely factual question, but also rests on criteria which each rate making authority may deem relevant." *Id.* at p. 61,869.

have been payable by customers had Nantahala received entitlements as described in the preceding paragraphs." *Id.* at p. 61,280.

In its order denying the rehearing requested by all parties, 20 F.E.R.C. ¶ 61,430, FERC rejected the claims of Alcoa and Nantahala that Opinion No. 139 actually reallocated the NFA entitlements and that it would result in the confiscation of Nantahala's property by setting rates below Nantahala's actual costs. FERC explained that its order merely set rates *as though* a portion of the interruptible entitlements were allocated to Nantahala:

> *In determining just and reasonable rates in Opinion No. 139, the Commission did not choose to reform the 1971 Apportionment Agreement and was not concerned with the mechanics of how entitlements of energy from TVA are allocated to each party, as long as each party receives its fair share of energy based on that party's contribution of actual energy turned over to TVA.* The mechanics of the proportions of both primary and secondary energy available from TVA rests with the parties. Our concern is that each party receive its proper entitlement. *Nantahala entered into a 1971 contract which we find unfair. As a result, the company had to make purchases from TVA which otherwise would not have had to be made. Nantahala must bear the consequences of its acts and refund rates collected to recover the costs of the excess purchases.*

20 F.E.R.C. ¶ 61,430 at p. 61,871. The practical effect of FERC's rate making methodology was the allocation to Alcoa of the "excess" costs Nantahala was forced to incur under the 1971 Agreement.

On appeal taken from the FERC's orders, the Fourth Circuit Court of Appeals held that: (1) FERC's finding that the 1971 Apportionment Agreement was unfair to Nantahala was supported by substantial evidence, and (2) the decision of FERC that a "roll-in" or consolidation of Nantahala and Tapoco for rate making purposes was *not necessary* in this instance was also supported by substantial evidence. *Nantahala Power and Light Co. v. FERC*, 727 F. 2d 1342. With respect to the latter point, the court recognized that although the evidence *did suggest* the propriety of a roll-in, the decision to order a roll-in rests within the discre-

tion of the agency charged with rate making responsibility. *Id.* at 1348. As to FERC's determination that the NFA was not unfair to Nantahala, the court adverted to the fact that "substantial weight in the NFA went to Alcoa's needs," but reasoned that that fact alone "is not conclusive proof that Alcoa sacrificed the Customers' interests to that of the Alcoa aluminum operations. It should be expected that more emphasis would be given to Alcoa's requirements than Nantahala's given the fact that Tapoco is much bigger than Nantahala, and in the early years of the NFA, even some of Nantahala's power and energy was sold to Alcoa." *Id.* at 1349.

We find a number of points particularly noteworthy with regard to the federal regulatory actions discussed above. First, FERC's entire examination of the factual issues common to both the wholesale and retail rate cases was undertaken in an effort to resolve legal issues not before the Commission and vice-versa. FERC's examination of the corporate structure of the Alcoa power system and the various intercorporate power transactions and agreements at issue was undertaken primarily in an effort to determine whether Alcoa had used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act, and having answered that question in the negative, FERC then declined to order the remedy of a roll-in.

[17] Contrary to the arguments of Nantahala and Alcoa, we conclude that FERC's analysis of the corporate structure and the various intercorporate power transactions and agreements at issue, and its finding that the evidence before it did not support the conclusion that Alcoa had used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act, does not preempt the Commission from determining that the evidence before it supports the conclusion that Alcoa had dominated Nantahala in such a manner as to require relief for Nantahala's retail customers under North Carolina law. Nor does FERC's having declined to order a roll-in of Nantahala and Tapoco for rate making purposes preempt the Commission from implementing such a rate making methodology under *its discretionary authority* in setting intrastate retail rates. Both the FERC and the Fourth Circuit Court of Appeals recognized that the decision to implement a "roll-in" (1) is based upon factors each regulatory body deems appropriate to the case before it; (2) rests within the discretion of the agency charged with such rate mak-

ing authority; and (3) is a matter upon which state and federal regulatory agencies may differ without the determination of the one necessarily binding the actions of the other.

We first observe that a fundamental factor in the differing treatment given by the federal and state regulatory bodies with respect to the NFA and the 1971 Apportionment Agreement arises out of their differing conclusions as to whether Nantahala is to be treated as a stand-alone company or as an integral unit in a single integrated and coordinated power system. The Commission's rejection of the companies' proposal to base Nantahala's energy and demand related costs on the entitlements it received under the contracts was based, in large part, on its findings that these entitlements were apportioned to Nantahala on the hypothetical and false assumption that Nantahala was developed and operated as a stand-alone utility company. No action taken by FERC may be said to preempt the Commission from rejecting a cost allocation formula based upon a factual premise that it has in turn properly rejected in the exercise of its rate making authority.

Moreover, with respect to FERC's treatment of the contracts themselves, it cannot be said that the findings of the Commission undermine an unequivocal FERC endorsement of the NFA and the 1971 Apportionment Agreement. FERC Opinion Nos. 139 and 139-A are far less inclusive in scope and approving in nature than the companies imply.

FERC did not, as both Alcoa and Nantahala repeatedly assert, find the NFA to be "just and reasonable," it merely determined that the contract was negotiated at "arms-length" and without the "intent" to "ignore" the needs of Nantahala's public customers. These findings are not tantamount to a determination that the contract equally benefits Nantahala's rate payers and Alcoa, or that its terms were required for or structured to be of benefit in service to those rate payers, which are matters the Commission was properly concerned with. More pointedly, and contrary to the assertions of Nantahala that FERC fully and unconditionally "deemed fair" the provisions of the 1971 Apportionment Agreement, FERC expressly found that agreement to be unfair to Nantahala and expressly refused to base Nantahala's rates to its wholesale customers upon the entitlements assigned to Nantahala under that agreement.

In fact, in setting those rates, FERC utilized a rate making methodology similar in principle to that implemented by the Commission—that is, FERC set Nantahala's wholesale rates on the lower level of energy related costs FERC determined Nantahala *should have* incurred given the relative contribution of its plants to the net generation Nantahala and Tapoco jointly turn over to TVA under the NFA. These determinations and the remedial rate making methodology employed by FERC were, in turn, fully affirmed by the Fourth Circuit Court of Appeals. It is therefore clear that the Commission's findings with respect to detriments Nantahala suffered by the terms of the 1971 Apportionment Agreement harmonize rather than conflict with findings by the FERC that the agreement was unfair to Nantahala.

The Commission's examination of the intercorporate agreements was undertaken in an effort to determine whether Nantahala and Tapoco function as a single, integrated electric system under North Carolina law and to determine what portion of the costs incurred by the "rolled-together" system under those contracts went to providing intrastate retail service to Nantahala's jurisdictional customers. Because the Commission determined that Nantahala incurred costs under the NFA and 1971 Apportionment Agreement that were, in effect, not required to serve its public customers and that it suffered substantial detriments thereunder, it declined to base Nantahala's demand and energy cost factors on the quantity and design of NFA entitlements Nantahala receives under the 1971 Apportionment Agreement.

The Commission, *in setting retail rates*, is no more bound to blindly apply specific rate schedules filed with and accepted by FERC, than is the FERC *in setting wholesale rates*—as opposed to *regulating* those specified rate schedules. The fact that the Commission chose a different rate making methodology than FERC to alleviate perceived inequities to Nantahala's retail customers and in so doing effectively allocated a greater proportion of system-wide costs to Alcoa (Tapoco) does not constitute a basis for rejecting the Commission's methods. State public service commissions need not follow FERC wholesale rate making methodologies; North Carolina regulatory policy, based upon factors appropriate to local utility regulation, may differ from FERC policy without necessarily coming into conflict with it. *See Public Systems v. FERC*, 709 F. 2d 73, 84 (D.C. Cir. 1983).

In view of these factors, and in light of our foregoing discussion of the respective spheres of federal and state rate making authority, we completely reject the various arguments presented by Alcoa and Nantahala on the question of federal preemption. These arguments are based, *inter alia*, upon the twin faulty premises that FERC has actually and directly approved the allocation scheme set up in the 1971 Apportionment Agreement and that the Commission's roll-in methodology impermissibly alters the costs associated with that contract and allocated to Nantahala. We have carefully examined the evidence of record, the actual mechanics of the roll-in and cost allocation performed by the Commission, and the relevant authorities on the question of federal preemption and conclude that the Commission has not crossed over the "bright line" between state and federal regulatory jurisdiction and intruded upon the federal domain, either directly or indirectly, in fixing Nantahala's retail rates in this proceeding.

B.

[18] The companies also argue that the Commission's order grants an unconstitutional preference to Nantahala's North Carolina customers over Tapoco's Tennessee customer (Alcoa) and impermissibly shifts the economic benefit of Tapoco power to Nantahala in violation of the limitation on state power implicit in the Commerce Clause of the United States Constitution (art. I, § 8, cl. 3) under the Supreme Court's decision in the *NEPCO* case, *New England Power Co. v. New Hampshire*, 455 U.S. 331, 71 L.Ed. 2d 188. We agree with the companies' contention that *NEPCO* establishes that a state utilities commission may not grant its citizens a preferred right to the benefit of hydroelectric energy generated by a utility in that state solely to gain an economic advantage over the utility's out-of-state customers, and that the granting of such a preferred benefit, regardless of how it is effectuated, places a direct and substantial burden on interstate commerce in violation of the Commerce Clause. However, we do not agree that the rule announced in *NEPCO* invalidates the action of the Commission in this case.

In *NEPCO*, hydroelectric power was produced in New Hampshire by the New England Power Company (NEPCO) and transferred to an out-of-state consortium of companies which served

six states and operated a power pool which included NEPCO. NEPCO then bought power from the pool, based on its pro rata share of the total average cost of power in the pool. This arrangement appreciably increased NEPCO's intrastate costs of service because its own hydro-generated power is cheaper to produce than most of the other generating sources in the consortium. The New Hampshire Commission, acting pursuant to a specific New Hampshire statute, terminated NEPCO's right to export its hydroelectric energy, and ordered the company to make arrangements to sell the previously exported hydroelectric energy to customers within the state. As the Supreme Court noted, although the precise contours of the New Hampshire commission's order were unclear in that it did not require the physical severance of NEPCO's connections with the power pool, it appeared to require NEPCO to sell electricity to New Hampshire utilities at special rates adjusted to reflect the savings attributable to the exclusive use of low-cost hydroelectric generation. *New England Power Co.*, 455 U.S. at 336, 71 L.Ed. 2d at 193. The commission's staff economist proposed that NEPCO effectuate the ban by allocating the economic benefit of the low-cost hydroelectric power to New Hampshire customers through "billing mechanisms" which would reserve the savings resulting from hydroelectric generation exclusively for in-state customers. *See id.* at n. 3.

On appeal, the Supreme Court of New Hampshire rejected the arguments of NEPCO and its out-of-state customers that the order was preempted by Parts I and II of the Federal Power Act and that it imposed impermissible burdens on interstate commerce. The United States Supreme Court reversed, holding that the New Hampshire commission's order attempted to restrict the flow of privately owned and produced electricity in interstate commerce in a manner inconsistent with the Commerce Clause of the United States Constitution (art. I, § 8, cl. 3) and that Section 201(b) of the Federal Power Act, 16 U.S.C. § 824(b) (the "savings clause") does not provide an affirmative grant of authority to the state to do so.

In rejecting the New Hampshire court's ruling, the Supreme Court explained its prior decisions under the implied limitation on state power in the Commerce Clause.

> Our cases have consistently held that the Commerce Clause of the Constitution, Art. I, Sec. 8, cl. 3, precludes a state from mandating that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its borders or to the products derived therefrom. (Citations omitted.) Only recently, . . . we reiterated that "[t]hese cases stand for the basic principle that a 'State is without power to prevent privately owned articles of trade from being shipped and sold in interstate commerce on the ground that they are required to satisfy local demands or because they are needed by the people of the State'." (Citations omitted.)

New England Power Co., 455 U.S. at 338, 71 L.Ed. 2d at 194-95. Applying this anti-protectionist rule to the actions of the New Hampshire commission, the Court, with little trouble, concluded:

> The order of the New Hampshire Commission, prohibiting New England Power from selling its hydroelectric energy outside the State of New Hampshire, is precisely the sort of protectionist regulation that the Commerce Clause declares off-limits to the states. The Commission has made clear that its order is designed to gain an economic advantage for New Hampshire citizens at the expense of New England Power's customers in neighboring states. Moreover, it cannot be disputed that the Commission's "exportation ban" places direct and substantial burdens on transactions in interstate commerce. . . . Such state-imposed burdens cannot be squared with the Commerce Clause when they serve only to advance "simple economic protectionism." . . . (Citations omitted.)

Id. at 339, 71 L.Ed. 2d at 195. Thus, in *NEPCO*, the Supreme Court held invalid not only a state utility commission order that prohibits that export of hydroelectric generation from one state to another, but also an order which *exclusively* reserves to the citizens of the producing state the full economic benefit of such hydroelectric power.

However, unlike the action of the New Hampshire commission, the roll-in performed by the Commission in this case does not purport to prohibit the exportation of energy produced within North Carolina, nor does it divert the flow of Tapoco's power to

Nantahala. More importantly, the roll-in methodology used by the Commission does not exclusively reserve to the citizens of North Carolina the entire economic benefit of the unified system's low-cost in-state hydroelectric generation.

As we have stated, the purpose of the roll-in employed by the Commission was the determination of the costs of service for the combined Nantahala-Tapoco system and the allocation of those costs as between the intrastate retail customers in North Carolina and the out-of-state industrial customer (Alcoa) in Tennessee. The practice of rolling-together accounting data and allocating costs between jurisdictional and non-jurisdictional service is common throughout the United States and is no different than the rate making techniques employed by the Commission in setting intrastate retail rates for other companies, such as Duke Power or Carolina Power & Light, which serve customers in more than one state. *Cf. Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 89 L.Ed. 1206; *Central Kansas Power Co. v. State Corporation Commission*, 221 Kan. 505, 561 P. 2d 779. The roll-in merely assures that Nantahala's in-state retail customers are not overcharged in order to subsidize a non-jurisdictional customer and that their rates accurately reflect the costs of facilities used in serving their demands upon the system.

In contrast to the action taken by the New Hampshire commission, the North Carolina Utilities Commission accepted the continuation and operation of all existing power supply agreements between and among the companies and TVA, and addressed neither the dispatch or transmission of electricity nor the actual division of energy and demand entitlements between Nantahala and Tapoco. Both Nantahala and Tapoco continued to deliver the output of their generating facilities to TVA and to receive power in exchange for resale. Under the order, Tapoco continues to deliver its return power to Alcoa and Nantahala continues to sell its share to its intrastate customers.

To support their analysis that the roll-in methodology used by the Commission constitutes an undue burden on interstate commerce under the *NEPCO* decision, the companies rely almost exclusively on one statement contained in the fifty-seven page order of the Commission. The statement is to the effect that the intervenors' proposed allocation methodology (later adopted by

the Commission), *assumed* that the North Carolina public load had a "first call on the total electric energy output of the combined Nantahala-Tapoco system." The companies essentially contend that this statement shows that the Commission was engaging in the same sort of admittedly protectionist behavior as the New Hampshire commission in *NEPCO*.

Although the argument has a certain surface appeal, it fails upon closer examination. Here, the Commission characterized the allocation methodology as premised upon a "first call" concept at the very outset of its discussion of the relative merits of the respective jurisdictional cost allocation methodologies proposed by the intervenors and the companies. However, the Commission went on to devote approximately thirty pages of its order to an analysis of (1) how the power supply agreements, *inter alia*, limited and rearranged the combined system's "demand" and "energy" availability to the detriment of Nantahala and corresponding benefit to Alcoa; (2) the various ways in which the companies' use of the apportionment of NFA demand and energy entitlements as a basis for the allocation of demand and energy costs would result in Nantahala's retail customers bearing costs properly allocable to Alcoa's use of Nantahala's resources; and (3) the preferable features of the intervenors' cost allocation methodology, which is based upon actual system capability and actual jurisdictional load responsibility for costs associated with supplying the system's entire load. The allocation factors ultimately used by the Commission do not allocate capacity and energy *availability* or *usage* between the combined system's jurisdictional and non-jurisdictional customers, but rather allocate "demand" and "energy" *costs* between the respective loads.

Alcoa concedes that no "dollar costs" incurred by Nantahala under the NFA and 1971 Apportionment Agreement are eliminated by the Commission's roll-in, but argues that the roll-in favors Nantahala's North Carolina customers by relieving them of all costs that TVA "charges" for the Fontana exchange and shifting those costs to the Tennessee load of Alcoa by means of the jurisdictional cost allocation methodology. Under the companies' proposed allocation formula, Nantahala would be assigned a percentage of demand and energy related costs based upon the demand and energy entitlements it receives under the power supply contracts. This percentage was somewhat higher than the percentage of costs developed by the Commission on the basis of demand and energy costs related to actual system capability and customer load demand under the intervenors' allocation methodology. Accordingly, Alcoa argues that in assigning Nantahala a "lower" percentage of costs than Nantahala "incurs" under the contracts, the Commission granted a preference for the in-state customers over the out-of-state customer.

Obviously, Alcoa's argument completely ignores the findings of the Commission that Alcoa had traded benefits usable and required by Nantahala for its public load in return for entitlements mainly usable and required by Alcoa's aluminum operations and so had already gained substantial benefits at the expense of Nantahala's public customers. Contrary to the assertions of Alcoa, intra-system retail costs of service were not allocated by the NFA and 1971 Apportionment Agreement and therefore the Commission was not bound to use the demand and energy entitlements in computing Nantahala's demand and energy related costs. The roll-in did not relieve Nantahala of all costs associated with the Fontana exchange in contravention of federal authority over those contracts, it merely determined which portion of those costs Nantahala was entitled to recoup by means of charges to its retail customers.

Despite the Commission's initial characterization, the rates actually set for Nantahala do no more than reflect the proportion of system costs of service fairly attributable to the provision of intrastate retail service. Nowhere does the Commission's discussion or application of the roll-in methodology actually implement a "first call" concept. The Commission has not granted North Carolina customers a preference to the economic benefits of hydroelectric energy generated in North Carolina at the expense of Alcoa in Tennessee, it merely eliminated from Nantahala's existing rate structure preferences and inequities which were effectuated in the past by basing Nantahala's rates on the fiction that it was a stand-alone company. This traditional exercise of its rate making authority is simply not proscribed by the rule established in *NEPCO*, or in other commerce clause cases.

It is well-settled in modern commerce clause jurisprudence that the existence of a commerce clause violation depends, in any case, upon "the nature of the state regulation involved, the objec-

tive of the state, and the effect of the regulation upon the national interest in the commerce." *Illinois Natural Gas Co. v. Central Illinois Pub. Serv. Co.*, 314 U.S. 498, 505, 86 L.Ed. 371, 376. The Supreme Court recently reformulated the basic test to be applied as follows:

> Where [a] statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. (Citation omitted.) If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Pike v. Bruce Church, 397 U.S. 137, 142, 25 L.Ed. 2d 174, 178 (1970).

In *Arkansas Elec. Coop. Corp. v. Arkansas Public Serv. Comm'n*, 461 U.S. 375, 76 L.Ed. 2d 1, the Court applied the *Bruce Church* test to the question of whether state public service commission *regulation* of wholesale electric rates charged by a rural power cooperative to its member retail distributors was forbidden by the Commerce Clause of the United States Constitution. The Court upheld such "even-handed" regulation, reasoning that (1) economic protectionism is not implicated by the traditional rate making functions of the state public service commissions;[22] (2) state regulation of wholesale rates charged by a rural power cooperative is well within the scope of "legitimate local public interest," particularly where the cooperative's basic operation consists of supplying power from generating facilities located within the state to member cooperatives, despite the fact that the cooperative is also tied into an interstate power grid; and (3) the effects on interstate commerce of state regulation of wholesale rates the cooperative charges its members are only incidental, so

22. *See also Kansas-Nebraska Natural Gas Co. v. City of St. Edward*, 234 F. 2d 436, 440 (8th Cir. 1953); *Zucker v. Bell Tel. Co. of Penn.*, 37 F. Supp. 748, 757 (E.D. Pa. 1974), *aff'd*, 510 F. 2d 971, *cert. denied*, 422 U.S. 1027, 45 L.Ed. 2d 684 (1975).

that the burden imposed on such commerce is not clearly excessive in relation to the putative local benefits.

In passing, the *Arkansas Electric* Court observed that despite the fact that most retail utilities receive a portion of the power they sell from out-of-state,

> [T]he national fabric does not seem to have been seriously disturbed by leaving regulation of retail utility rates largely to the States. Similarly, it is true that regulation of the prices AECC [the cooperative] charges to its members may have some effect on the price structure of the interstate grid of which AECC is a part. But, again, we find it difficult to distinguish AECC in this respect from most relatively large utilities which sell power both directly to the public and to other utilities.

461 U.S. at 395, 76 L.Ed. 2d at 17. Thus, it is clear that in the ordinary case, and absent acts of pure economic protectionism, state regulatory action affecting both jurisdictional and nonjurisdictional customers that imposes only incidental effects upon interstate commerce will not be found to offend the Commerce Clause of the United States Constitution.

Again, the roll-in, as employed by the Commission, does no more than establish the overall cost of operation of a single, unified Nantahala-Tapoco system and allocates the proper portion of those costs to North Carolina retail customers for the purpose of fixing just and reasonable rates for Nantahala. Such evenhanded and traditional rate making operations do not implicate the national concern with "economic protectionism" discussed in the *Bruce Church* case. Moreover, the setting of retail electric rates for Nantahala's customers is clearly a legitimate North Carolina interest with a significant impact in this state. Not a word of the contracts or agreements properly regulated by FERC has been changed, and the fact that the price charged by Nantahala to its retail customers may have some *de minimis*, incidental effect on the price structure of the interstate "grid" of which Nantahala is a part is not clearly excessive in relation to the substantial public interest in the establishment of just and reasonable electric rates for ultimate North Carolina consumers. *See Arkansas Elec. Coop. Corp. v. Arkansas Public Serv. Comm'n*, 461 U.S. 375, 76 L.Ed. 2d 1. Accordingly, we conclude that the Commission's order does not

impose an undue burden on interstate commerce and is not, therefore, prohibited by the Commerce Clause of the United States Constitution.

We take this opportunity to note that an amicus curiae brief has been submitted in this appeal on behalf of the State of Tennessee and one of its agencies, the Tennessee Department of Economic and Community Development. The State of Tennessee is concerned that any increase in power costs at Alcoa's Tennessee facilities resulting from the Commission's order will create the danger of Alcoa's curtailment of production, with consequent layoffs of many local residents there. The State joins in the position of the companies (Alcoa, Tapoco) that the Commission's order interferes with FERC's exclusive jurisdiction to regulate the way in which energy is allocated and sold in interstate commerce and in the companies' argument that the roll-in order has the practical effect of allocating the power output and the economic benefit of Tapoco's operations to Nantahala in contravention of both federal authority and the federal constitution. The legal issues adverted to in the amicus brief are, of course, addressed in our discussion of the arguments presented by the companies themselves. We are fully cognizant of the broader concerns expressed by the State of Tennessee, however, we find no impermissible preferences or reallocation of resources to be embodied in the Commission's order. Rather, we conclude that the order grants precisely the relief which the State of Tennessee requests in its brief, that is, the order "ensure[s] all affected persons and entities of fair treatment in the allocation of power resources."

C.

Both Nantahala and Alcoa challenge the rate reduction and refund obligation imposed by the Commission for the locked-in period of this docket (1977-1981). Nantahala argues that implementation of the roll-in methodology causes it to suffer a revenue shortfall which affects its financial stability and amounts to confiscation of its properties in violation of the Due Process Clause of the Fourteenth Amendment to the United States Constitution and art. I, § 19 of the North Carolina Constitution (the "law of the land" provision). Alcoa attacks both the Commission's authority to impose liability upon it for Nantahala's refund obligation and the results of that imposition as confiscatory under the federal con-

stitution. We find no merit in any of the companies' arguments concerning the rate reduction or refund obligation.

1.

As indicated in Part I of this opinion, Nantahala initiated this proceeding in 1976 to establish new rates based upon the 1975 test year data so as to increase its charges to North Carolina retail customers by $1,830,791. On 14 June 1977, the Commission issued an order in Docket No. E-13, Sub 29, permitting Nantahala to put into effect revised rates so as to produce $1,598,918 in additional gross revenues. This rate increase was based upon the assumption, later and properly rejected by the Commission, that Nantahala was a stand-alone company, that its stand-alone reasonable expenses, including interest on its outstanding debt, were $9,827,514, and that its stand-alone authorized gross revenues were $11,067,000. Under the roll-in methodology used in the remanded proceedings, Docket No. E-13, Sub 29 (Remanded), Nantahala is authorized, through its rates, to collect revenues in the amount of $9,032,000 (exclusive of purchased power costs), while Nantahala's rolled-in reasonable expenses are determined to be $8,322,000. The refund imposed of $2,035,000 annually, was based upon the difference between the revenues being collected under the 14 June 1977 order in the amount of $11,067,000 and the revenues authorized in the 2 September 1981 order in the amount of $9,032,000. In other words, the refund obligation is the difference in amount between Nantahala's actual rate collections between June 1977 and August 1981, and what those collections would have been under the rolled-in rates, plus interest.

a.

[19] Nantahala contends that the roll-in sets revenues for the utility which are below its "actual" or "book" expenses and thus requires it to operate at a loss. The company arrives at its revenue shortfall conclusion by subtracting its rolled-in authorized revenues from the expenses authorized in the 1977 order on the premise that Nantahala was a stand-alone company. That is, by subtracting the $9,032,000 in gross revenues authorized under the roll-in from the $9,827,514 in reasonable expenses determined for the 1975 test year on the stand-alone premise, Nantahala arrives at an approximate $800,000 "revenue shortfall." Nantahala uses the same methodology in comparing rolled-in authorized revenues

to stand-alone authorized revenues under the 1977 order in support of its argument that the approximately $2 million annual reduction in revenues from the previously established level will deplete the utility of earnings with which to pay an equity return to its shareholder or to furnish capital for plant expansions and new service connections as its load grows. It is Nantahala's contention that the Commission, on remand, did not determine that the expenses it had earlier found reasonable would not actually be incurred by Nantahala, or that the losses thus engendered would be ameliorated by the roll-in, and that the ultimate result of the roll-in will be Nantahala's financial insolvency.

The obvious flaw in Nantahala's "revenue shortfall" argument lies in the company's failure to compare authorized rolled-in revenues to authorized rolled-in expenses. In the order appealed from, Finding of Fact No. 17 authorizes Nantahala, through its rates, to collect revenues in the amount of $9,032,000 (exclusive of purchase power costs) while Finding of Fact No. 14 recognizes Nantahala's reasonable expenses to be $8,322,000. The difference between the two figures represents profit. Consequently, Nantahala is permitted to earn a proper income over and above the rolled-in expenses that the Commission has determined were reasonably incurred in the provision of service to Nantahala's retail customers.

The fact that Nantahala claims it *actually* has incurred a higher level of expenses under the various inter-corporate agreements between itself, its affiliates and TVA is not dispositive; it is for the Commission, and not the company, to determine what portion of those total expenses are to be reflected in the retail rates charged Nantahala's North Carolina customers. It must be remembered that this is a general rate case, and that under N.C. G.S. Chapter 62, the Commission must fix such rates "as shall be fair to both the public utility and to the consumer." N.C.G.S. § 62-133(a). While the Commission is to fix rates that will enable the utility *by sound management* to pay all of its costs of operation and have left a fair return upon the fair value of its properties, it is not required to guarantee the return requested by the utility where the facts and circumstances warrant otherwise. *Utilities Comm. v. Telephone Co.*, 285 N.C. 671, 208 S.E. 2d 681. As noted earlier, the primary purpose of Chapter 62 is to assure the public of adequate service at a reasonable charge; the provi-

sions of this chapter of the General Statutes designed to assure the utility of adequate revenues do not take precedence over, but "are in the nature of corollaries to the basic proposition that the public is entitled to adequate service at reasonable rates. . . ." *Id.* at 680, 208 S.E. 2d at 687. Furthermore, as this Court noted in *Utilities Comm. v. Telephone Co.*, the question of whether rates prescribed under Chapter 62 are so unreasonable and unjust to the company and its stockholders, and so amount to an unconstitutional confiscation of a utility's property necessarily "involves an inquiry as to what is reasonable and just for the public. . . . The public cannot properly be subject to unreasonable rates in order simply that stockholders may earn dividends." 285 N.C. at 682, 208 S.E. 2d at 688, *quoting Covington & Lexington Turnpike Road Co. v. Sandford*, 164 U.S. 578, 596-97, 41 L.Ed. 560, 566 (1896).

Having found that Nantahala's parent/customer Alcoa had already received substantial concealed benefits at the expense of Nantahala's retail rate payers under the NFA and 1971 Apportionment Agreement, the Commission was entitled to weigh that benefit in balancing the interests of Nantahala's rate payers and the utility's sole shareholder, Alcoa. In view of the Commission's determination that unsound or "absentee" management decisions on the part of Nantahala, and parental domination on the part of Alcoa, left the utility with insufficient resources to meet its steadily increasing public load and lacking in contractual power supply arrangements tailored to meet its public service needs at reasonable prices, it was well within the Commission's rate making authority to shift the onus of those managerial shortcomings from the pockets of Nantahala's retail rate payers to the corporate offices of the "Alcoa power system." In short, we reject Nantahala's arguments that the rolled-in rates cause it to operate at a loss and in so doing confiscates its property.

b.

In essence, the Commission set Nantahala's rates and ordered refunds so as to return to Nantahala's retail customers the benefits which the Commission found had been unfairly diverted to Alcoa by means of Alcoa's domination of Nantahala. The principal amount of the refund obligation imposed on Nantahala is $18,962,000. By December 1983, that figure had grown to

$25,568,433. Nantahala's entire net worth as of 31 December 1983 was $15,700,000. Thus, the full extent of the costs unfairly imposed upon Nantahala's rate payers under the 1977 order was substantially greater than Nantahala itself could afford to return; the economic benefits in question had already been flowed-through to Alcoa. Therefore, to prevent the frustration of its ability to effectively protect Nantahala's customers, the Commission ordered Alcoa, over whom the Commission had previously asserted jurisdiction as a statutory public utility pursuant to N.C. G.S. § 62-3(23)c, to pay Nantahala's refund obligations to the extent that Nantahala itself is unable to do so and continue to render adequate service. Thus, Nantahala is not left bereft of resources with which to meet its obligations.

Nantahala, however, contends that its *potential* refund obligation coupled with the rate reduction prevented the utility from attracting either debt or equity financing which will be needed to meet both its service obligation and its anticipated need to expand its facilities as growth in demand on its system occurs. Nantahala observes that the Commission's order places the refund obligation on Nantahala whether or not Alcoa can be forced to contribute, so that if Alcoa is determined not to be liable for these refunds, Nantahala will be obligated to refund the entire amount. The utility implies in its brief that this situation has placed a "chill" on its credit rating. In addition, Nantahala points out that Alcoa contends that it bears no refund liability and has stated that it will make payments, "only after exhaustion of all federal and state judicial remedies and legal rights." On this basis, Nantahala argues that the requirement that it make refund payments to customers far in excess of its net worth or what it could obtain in complete liquidation of its assets also results in an unconstitutional confiscation of its property. Because Nantahala's argument concerning the refund obligation turns upon the determination of Alcoa's refund liability, we will now address the challenges Alcoa presents to the Commission's order holding it responsible for so much of the refund obligation as Nantahala is itself unable to pay.

2.

Alcoa has abandoned its argument that it is not a statutory public utility under N.C.G.S. § 62-3(23)c, as found by the Commis-

sion and affirmed by the Court of Appeals. However, the company now argues that the Commission lacks the authority to impose any refund obligation upon Alcoa on this basis and, in any event, lacks the authority to charge Alcoa with the obligation to refund any revenues collected by Nantahala prior to 3 October 1980, the date on which the Commission ruled that Alcoa was a statutory public utility. We conclude that the Commission acted well within its regulatory authority in imposing the obligation upon Alcoa to pay any part of the refund obligation for the entire locked-in period of this docket that Nantahala is itself unable to pay.

Alcoa's challenge to the Commission's basic authority to order it to pay any portion of Nantahala's refund obligation may be summarized as follows: (A) Alcoa's status as a public utility under N.C.G.S. § 62-3(23)c does not, in itself, give the Commission a basis for imposing liability on it for Nantahala's refund; (B) there is no legal or factual basis for the Commission to reach that result by either "piercing the corporate veil" between Alcoa and Nantahala or by applying the "no profits to affiliates" rule; and (C) federal regulation of the companies and transactions at issue prohibits piercing of the corporate veil. None of these contentions has any merit.

a.

[20] Initially, we note that in a general rate case, the Commission is empowered to fix rates for *any* public utility subject to the provisions of Chapter 62. Ordering refunds is an inherent part of the rate making function of the Commission. *See Utilities Comm. v. Edmisten, Atty. General*, 291 N.C. 451, 232 S.E. 2d 184 (refunds to customers ordered to remedy excessive utility charges arising out of improperly approved fuel cost adjustments in retail rates). Moreover, pursuant to N.C.G.S. § 62-30, the Commission is vested with broad authority to insure the effective regulation of public utilities in North Carolina, including "all such . . . powers and duties as may be necessary or incident to the proper discharge of its duties."

N.C.G.S. § 62-3(23)c denominates the parent of a public utility to be, itself, a public utility to the extent "that such affiliation has an effect on the rates or service of such public utility." Alcoa first argues that this statutory provision is "merely jurisdictional" and permits the Commission to "assert" its regulatory authority over

the parent corporation, but fails to provide a basis for remedial action should the affiliation be found to have a detrimental effect on the subsidiary. Next, Alcoa maintains that no other provision of the General Statutes gives the Commission such remedial jurisdiction over a statutory public utility, so that the Commission lacked a legal basis for holding Alcoa liable for Nantahala's refund obligation. We disagree.

Under Alcoa's interpretation of N.C.G.S. § 62-3(23)c it is difficult to conceive of what the "assertion" of such an empty regulatory authority would consist of. The very language of this provision indicates that it must have been the purpose of the legislature to empower the Commission to hold the corporate parent or affiliate of a public utility financially accountable for any adverse effects of that affiliation on the subsidiary's rates or service as a necessary adjunct to the discharge of its statutory duties under N.C.G.S. § 62-30. Furthermore, Alcoa's reading of N.C.G.S. § 62-3(23)c is wholly at odds with the general powers and duties granted the Commission under Chapter 62 of the General Statutes.[23]

It is beyond dispute that Nantahala's financial stability and hence its ability to serve the public depends on Alcoa's ultimate legal responsibility to stand behind the refund obligation. The broad grants of authority to the Commission to ensure the effective regulation of Nantahala and the full protection of Nantahala's customers would be rendered nugatory if, upon a finding that its parent's affiliation had severely and detrimentally affected Nantahala's rates and ability to effectively provide service in its franchise area, the Commission were powerless to order remedial action against the parent corporation. Therefore, we reject Alcoa's restrictive interpretation of the purpose of N.C.G.S. § 62-3(23)c and the scope of the Commission's statutory powers.

23. For example, N.C.G.S. § 62-42(a)(5) authorizes the Commission to enter orders directing a public utility to do ". . . any other act necessary to secure reasonably adequate service or facilities and reasonably and adequately to serve the public convenience and necessity. . . ;" subsection (b) permits an order to be directed to "two or more public utilities," and N.C.G.S. § 62-32 authorizes the compelling of a public utility to render reasonable service at reasonable rates.

b.

The provision of electric service, and the development of the hydroelectric resources of North Carolina, are enterprises in which the public has a special interest, and which are accordingly subject to special duties and regulation. N.C.G.S. § 62-2; *Public Service Co. v. Power Co.*, 179 N.C. 18, 101 S.E. 2d 593 (1919); *North Carolina Public Service Co. v. Southern Power Co.*, 282 F. 837 (4th Cir. 1922), *cert. denied*, 263 U.S. 508, 68 L.Ed. 413 (1924). When a public utility is affiliated with other corporations, it is often necessary to look beyond corporate form to determine the actual scope of the public service enterprise in question, in order to prevent evasion of the obligations imposed on that public service enterprise. *See generally* Berle, *The Theory of Enterprise Entity*, 47 Col. L. Rev. 343, 343-45, 348-52 (1947). This Court has repeatedly recognized the propriety of "piercing the corporate veil" in the context of utility regulation. In *Utilities Comm. v. Morgan, Attorney General*, 277 N.C. 255, 177 S.E. 2d 405 (1970), *aff'd on rehearing on other grounds*, 278 N.C. 235, 179 S.E. 2d 419 (1971), Justice Lake, writing for the Court, stated:

> It is well established that the doctrine of the corporate entity may not be used as a means for defeating the public interest and circumventing public policy. . . . In order to prevent such a result, a parent corporation and its wholly-owned subsidiaries may be treated as one. (Citations omitted.)

277 N.C. at 272, 177 S.E. 2d at 416. *Accord Utilities Commission v. Intervenor Residents*, 305 N.C. 62, 286 S.E. 2d 770; *Utilities Comm. v. Telephone Co.*, 281 N.C. 318, 189 S.E. 2d 705.[24] *See generally* 64 Am. Jur. 2d, Public Utilities, § 202 (1972); 16 A.L.R. 4th 454, § 4. Indeed, the inherent authority of the Commission to

24. In the *Morgan, Intervenor Residents* and *Telephone Company* cases this Court has recognized that the Commission should closely scrutinize transactions between a public utility and an *unregulated* affiliate, in order to prevent either the utility enterprise from effectively earning a greater profit than the Commission had determined to be reasonable, or from concealing or diverting profits from the public utility to the affiliate. Surely the Commission has no less authority to regulate the results of transactions between a jurisdictional or statutory public utility and its affiliated operating public utility than it has to regulate transactions between an unregulated affiliate and a public utility. We therefore reject, in passing, Alcoa's argument that the Commission could not also rely on the "no profits to affiliates" rule to hold it liable for Nantahala's refund obligation.

pierce the corporate veil between a public utility and its parent corporation in order to prevent the evasion of effective regulation was implicitly recognized in an early commercial rate discrimination case involving Nantahala and its parent/customer Alcoa. *Utilities Commission v. Mead Corp.*, 238 N.C. 451, 78 S.E. 2d 290 (Barnhill, J., concurring) (Nantahala may not structure its rates so as to accord its parent Alcoa an unreasonably favorable rate).

Therefore, once the Commission determined that Alcoa was a statutory public utility under N.C.G.S. § 62-3(23)c, it could rely upon the doctrine of "piercing the corporate veil" between Nantahala and its parent to hold Alcoa financially responsible for Nantahala's refund obligation to the extent its affiliation had adversely affected Nantahala's rates as "necessary or incident" to the proper discharge of its regulatory duties under Chapter 62. N.C.G.S. § 62-30. Accordingly, we reject Alcoa's argument that there is no statutory or legal basis for its refund liability.

[21] Alcoa next maintains that "as a matter of law" there is no factual basis in the record before the Commission for piercing the corporate veil between it and Nantahala. Alcoa's argument may be summarized as follows: (1) North Carolina law requires a finding of corporate domination utilized by the parent to commit fraud or injustice with respect to the transaction attacked; (2) the Commission's determinations are based solely on the fact of Alcoa's 100 per cent stock ownership of Nantahala and its conclusion that the NFA and 1971 Apportionment Agreement were negotiated so as to benefit Alcoa at the expense of Nantahala's customers, thereby leaving Nantahala an "empty shell"; (3) stock ownership, without more, is no basis for piercing the corporate veil and the "empty shell" characterization cannot stand as a basis for domination or injury to the rate payer because both the NFA and 1971 Agreement "have been thoroughly regulated (and approved) by FERC"; and (4) a state commission is preempted from determining that the Nantahala-Alcoa relationship resulted in fraudulent wholesale rate schedules once these rate schedules have been determined to be reasonable by FERC. Although these contentions have a certain logical appeal, they are patently lacking in merit as a matter of both law and fact.

In its order reducing rates and imposing the refund, the Commission found as a fact that:

> Alcoa has so dominated certain transactions and agreements affecting its wholly owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina.

In the concluding portion of the Commission's extensive discussion of evidence demonstrating Alcoa's control over the design, development and operation of Nantahala from its inception, the Commission stated:

> The Commission must conclude that Alcoa has so dominated these transactions and agreements affecting its wholly owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina. Alcoa's domination of Nantahala in these transactions has resulted in Nantahala's collecting, through its base rates, excess revenue from its customers in the amount of approximately $2,035,000 a year since June 14, 1977. Moreover, this inequity is further magnified by the fact that Nantahala has collected significantly additional excess revenues through operation of its Purchased Power Adjustment Clause.

First, it is apparent that there is nothing in the Commission's order which indicates that "fraud" was either an express or implied concern of the Commission. Rather, detrimental domination forms the basis of Alcoa's refund obligation. Next, Alcoa misconceives the need to demonstrate "fraud" in order to pierce the corporate veil between affiliated companies that comprise a single enterprise, whether that enterprise be a public utility or an unregulated business concern. Although we have previously acknowledged the propriety of disregarding separate corporate identities where a parent is found to have used its subsidiary as a mere "instrumentality" for the commission of fraud upon some third party, this Court has never limited the doctrine of piercing the corporate veil to the situation of fraud alone. In *Huski-Bilt, Inc. v. Trust Co.*, 271 N.C. 662, 157 S.E. 2d 352 (1967), the very case Alcoa relies upon in its brief, we stated the three elements which must be proved under the "instrumentality rule" as follows:

(1) Control, not mere majority or complete stock control, but complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and

(2) Such *control* must have been *used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights*; and

(3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of. (Emphasis added.)

Id. at 670-71, 157 S.E. 2d at 358, *quoting Lowendahl v. Baltimore & O. R. Co.*, 247 A.D. 144, 157, 287 N.Y.S. 62, 76, *aff'd*, 272 N.Y. 360, 6 N.E. 2d 56 (1936). Clearly, despite the fact that the second element *includes* control and domination of the subsidiary or affiliate for the commission of some "fraud," it is by no means limited thereto and in fact, expressly includes domination for the commission of some unspecified "wrong," to "perpetrate the violation of a statutory or other positive legal duty," *or* an act in "contravention" of the complainant's "legal rights."

In fact, our courts have pierced the corporate veil between two corporations, or between a corporation and its sole shareholder(s), to prevent the frustration of public policy in numerous cases where fraud was not involved. *See, e.g., Waff Brothers, Inc. v. Bank*, 289 N.C. 198, 221 S.E. 2d 273 (1976) (to prevent a judgment debtor's meritorious claim from being defeated); *Henderson v. Finance Co.*, 273 N.C. 253, 160 S.E. 2d 39 (1968) (to prevent a finance company from evading the usury laws); and *Freeman v. Development Co.*, 25 N.C. App. 56, 212 S.E. 2d 190 (1975) (to enable recovery on meritorious contract and quasi-contract claims). Most recently, this Court held that the corporate veil between affiliated corportions will be pierced to prevent the owner of a rental property to escape liability for the tortious conduct of its affiliated operating company. *Glenn v. Wagner*, 313 N.C. 450, 329 S.E. 2d 326 (1985).

Significantly, in *Glenn v. Wagner*, we *relaxed* the showing to be made by the party seeking to extend liability for corporate

obligations beyond the confines of a corporation's separate entity by holding that in certain cases involving affiliated corporations (as distinct from parent and subsidiary corporations), the domination sufficient to pierce the corporate veil need not be limited to the particular transaction attacked. Rather, the separate corporate entity would be disregarded in those cases in which one affiliated corporation is shown to be "without a separate and distinct corporate identity and is operated as a mere shell, created to perform a function for an affiliated corporation or its common shareholders" without the necessity of proving that the control was also exercised over the *particular* transaction attacked. 313 N.C. at ---, 329 S.E. 2d at 331.

In reaching this result, Chief Justice Branch, writing for the Court, emphasized the fact that the theory of liability under the instrumentality rule is essentially an equitable doctrine.

> Its purpose is to place the burden of the loss upon the party who should be responsible. Focus is upon the reality, not form, upon the operation of the corporation, and upon the defendant's relationship to that operation. It is not the presence or absence of any particular factor that is determinative. Rather, it is a combination of factors which, when taken together with an element of injustice or abuse of corporate privilege, suggest that the corporate entity attacked had "no separate mind, will or existence of its own" and was therefore the "mere instrumentality or tool" of the dominant corporation.

Id. at ---, 329 S.E. 2d at 332. *Glenn v. Wagner* merely reiterated our earlier rule permitting the corporate veil between a parent and subsidiary corporation to be pierced where the parent has dominated the subsidiary and the subsidiary is "a shield for [the parent's] activities in violation of the declared public policy or statute of the State, *or* for the purpose of fraud. . . ." *Waff Brothers*, 289 N.C. at 210, 221 S.E. 2d at 280. (Emphasis added.)

Moreover, even if Alcoa were correct as to the other elements necessary to pierce the corporate veil under North Carolina law, the evidence supporting the Commission's imposition or refund liability upon Alcoa more than met the most restrictive of the various tests for inter-corporate liability—the so-called "*Lowendahl*" test—as articulated in *Huski-Bilt* and *Ac-*

ceptance Corp. v. Spencer, 268 N.C. 1, 149 S.E. 2d 570 (1966). As we indicated in Part I, C, 3 of this opinion, there is ample evidence of record of Alcoa's financial and managerial control over Nantahala from the time of its inception up until the present day, and plenary evidence demonstrating that this control extended to the ultimate operating and accounting policies of its subsidiary.

The entire historical pattern of Nantahala's development is replete with instances of the manner in which Alcoa dominated the development, sale and operation of Nantahala's hydroelectric resources and facilities, and subordinated these resources to what Alcoa considered to be the paramount needs of its aluminum smelting and fabrication operations in Alcoa, Tennessee. For example, Nantahala added generating capacity, vastly in excess of the amounts required to service its public load, for the express purpose of meeting Alcoa's expanding production needs prior to and during the war years at mid-century. Yet, in the last thirty years, Alcoa has caused Nantahala to remain inert in terms of obtaining additional capacity, either through development of additional generating facilities or through long-term purchase power agreements with others tailored to Nantahala's particular needs, as Alcoa's electricity requirements have leveled off, despite substantial constant growth in Nantahala's public load. As we observed earlier, Alcoa's unified development of the hydroelectric resources of its public utility subsidiaries was undertaken in the paramount interest of obtaining low-cost hydroelectric power for itself. Or, as more succinctly stated by Justice Barnhill in *Utilities Commission v. Mead Corp.*, 238 N.C. at 467-68, 78 S.E. 2d at 302:

> If they [the Commission] will only cut through the form to the substance, they will find just another hydroelectric power producing agency of Alcoa, retailing just enough of its production—less than 20%—to permit it to pose as a *quasi*-public corporation with the right to use the water power resources of this State, exercise the power of eminent domain, and enjoy the other monopolistic privileges accorded a public utility while it was, in fact, created and exists primarily to serve its master which seeks and must have low-cost hydroelectric power.

Justice Barnhill's 1953 observation that historically Nantahala has been no more than "another hydroelectric power producing agency of Alcoa" was fully borne out by the evidence before the Commission in 1981, as the Commission properly so found.

Furthermore, the evidence with respect to Alcoa's complete domination of Nantahala's "policy and business practice in respect to the transaction attacked," as found by the Commission, is both direct and overwhelming.

The three basic power supply contracts affecting Nantahala's rates are the 1941 Original Fontana Agreement, the 1962 New Fontana Agreement and the 1971 Nantahala-Tapoco Apportionment Agreement. Each of these contracts was, in whole or part, in effect during the 1975 test year. Although Nantahala was not even a party to the OFA, it gave to TVA the right of control of its energy production and water storage and turned over to TVA, through Alcoa, land, constituting the site for the massive Fontana Project. In return, Alcoa received 11,000 mw of energy for 20 years and its subsidiaries received power and energy entitlements dependent upon the level of generation controlled by TVA. The Commission found that the OFA still conveys significant benefits to Alcoa. Pursuant to the NFA, to which Nantahala was a *signatory* but *not* a *negotiating party*, Nantahala and Tapoco agreed to turn over their energy production to TVA in return for 218,300 kw annual assured energy. The Commission found and concluded that the evidence clearly demonstrates that the NFA was tailored to meet Alcoa's aluminum production needs without consideration of Nantahala's public service needs in western North Carolina.

From 1963 to 1971 Nantahala received its portion of the return entitlements under the 1963 Alcoa-Nantahala Apportionment Agreement. Under that agreement, Nantahala was provided 360 million kwh minimum production, plus Nantahala's actual production in excess of that figure, and additionally, Alcoa paid to Nantahala $89,200 annually for 25,600,000 kwh of energy received from TVA for TVA's use of Nantahala's flood control and storage rights. In 1971, with Nantahala facing the need to service an increasing public load, Alcoa employee George Popovich undertook the development of an apportionment formula by which Nantahala and Tapoco would contractually share the TVA entitlement

of 218,300 kw annual assured energy. The Popovich formula was incorporated into the 1971 Agreement between Nantahala and Tapoco, with Alcoa's employee Popovich representing the interests of *both* companies at the bargaining table. Under the 1971 Agreement, Nantahala rather than retaining or even increasing its allocation, was deprived of 66 million kwh average energy production annually in comparison to its 1963 Agreement with Alcoa. Since the production allowance in the TVA return entitlements was jointly shared by Nantahala and Tapoco under the NFA, the 66 million kwh detriment to Nantahala constituted a benefit to Tapoco that was passed on to Alcoa. Furthermore, the 1971 Agreement credited Nantahala with an assigned generating capacity of 54,300 kw, whereas its actual dependable generating capacity was determined to be 81,800 kw. Since the capacity allowance in the TVA return entitlements was also jointly shared by Nantahala and Tapoco under the NFA, any capacity needs of Nantahala between its assigned and its actual capacity represented an expense to Nantahala and, thus, a saving to Tapoco that was passed on to Alcoa as a concealed benefit.

In addition, under the 1963 Agreement, Nantahala received credit for relinquishing control of its flood control and storage rights to TVA, in the form of an annual payment of $89,200 from Alcoa. Despite the fact that the NFA included in the TVA return entitlement a reimbursement by TVA for the right to operate Nantahala's projects, the 1971 Agreement gave no credit to Nantahala for that reimbursement, and thus the reimbursement represented a savings to Tapoco that was passed on to Alcoa. Although the loss of the right to control the storage and flow of water for Nantahala's facilities constituted a loss of considerable value for which Nantahala was entitled to compensation, Nantahala received neither payments nor entitlements in consideration for relinquishment of these valuable rights. Additionally, the value to Tapoco of TVA's upstream Fontana Dam, was not figured into the apportionment.

Singularly lacking in the foregoing review is any evidence of the separate mind, will or existence of Nantahala as a corporation with its own identity. The Commission properly found that Nantahala and Tapoco were designed and operated as a single system and that by virtue of the terms of the Fontana Agreements, Nantahala is effectively precluded from exercising a separate will

regarding energy production. Moreover, no Nantahala employee has yet been identified who dealt with other parties at arm's length concerning the utilization of its generating resources for supplying power for Nantahala's public service obligations. To the contrary, and as found by the Commission, "Alcoa's dominance is obviously and frequently documented in the results of various arrangements it has caused Nantahala and Tapoco to enter into."

In summary, the evidence of record shows that the Fontana Agreements and the 1971 Apportionment Agreement resulted in direct inequities to Nantahala and concealed benefits to Alcoa. The situation was further aggravated because the TVA return entitlements in the NFA were entirely designed to meet Alcoa's aluminum production needs and were not suitable for Nantahala's public service needs. Nantahala had energy production capacity and it had peaking capacity from its own generating stations, yet Nantahala gave up that energy production capacity and that peaking capacity with the result that it had to buy higher cost power from TVA to meet its peaking responsibilities and its energy production responsibilities. The totality of this evidence shows convincingly that Alcoa has controlled the policy and business practice of Nantahala's energy production through a series of contractual arrangements orchestrated by Alcoa primarily to serve its own best interests.

The evidence as to Alcoa's use of its control over Nantahala to commit the wrong, or violation of duty complained of by the intervenors was equally substantial. Fundamentally, the record shows that Nantahala continually failed to protect its rights in its dealings with Alcoa and Tapoco concerning the power supply vital to fulfilling its public service responsibilities. For example, the NFA is silent as to any interest of Nantahala in receiving an assured portion of the return entitlements given by TVA in exchange for receiving the entire output of the Nantahala-Tapoco generating resources, except to state that the rights and benefits to Alcoa may be allocated as Alcoa, Tapoco and Nantahala see fit. The silence as to Nantahala's interest is understandable only in light of the fact that during the year 1962 Nantahala had no reason to bargain at arm's length for power suited to its public service load because the attempt to sell its distribution system to Duke Power Company was pending, and had in fact received initial approval by the Commission. Alcoa's own internal documents

indicate that should the sale have not been completed by the effective date of the NFA, TVA would *temporarily* increase the power available to the Alcoa system in an amount sufficient to meet Nantahala's needs, thus implying that the NFA was itself in no manner intended to provide Nantahala with a 20 year power supply suitable for a growing public load. However, no fundamental changes in the terms of the NFA exchange were made following this Court's reversal of the prior order of the Commission approving the sale to Duke. The circumstances surrounding execution of the NFA ultimately required Nantahala to deal separately with Alcoa, outside the NFA, for recognition of its interests.

Again, this arrangement demonstrates that although Alcoa bargained with TVA concerning the value of Nantahala's generating resources as part of a unified utility system, the structure of the NFA return entitlements suited Alcoa, not Nantahala. Later, by the terms of the 1971 Apportionment Agreement, Nantahala effectively waived certain valuable contractual rights it had been accorded under the 1963 Agreement with Alcoa *and* simultaneously received a lesser share of the TVA entitlements at a precise point in time when its load was quickly outstripping its ability to serve under the terms of the NFA exchange. The 1971 Agreement represents more than a failure of consideration to Nantahala; there was diminution of past consideration in contravention of Nantahala's legal rights.

Nantahala is a public utility with a franchise to serve the electrical needs of most of six western North Carolina counties and, in the test year, served upward of 30,000 customers. In return for the various quasi-monopolistic privileges Nantahala receives as a public utility, Nantahala has a duty to serve its customers without concealment of excessive rates. *Utilities Comm. v. Telephone Co.*, 281 N.C. 318, 189 S.E. 2d 705. By virtue of the domination of Alcoa, Nantahala was found to have been passing concealed benefits on to Alcoa which has resulted in excessive rates to its customers. This constitutes unjust action by Alcoa in contravention of Nantahala's legal rights and obligations. That this domination and unjust action in contravention of Nantahala's rights and obligations proximately caused the injury and loss complained of is, therefore, self-evident.

c.

[22] Alcoa does not directly challenge the evidentiary support for the Commission's findings and conclusions. Rather, Alcoa argues that "federal regulation and approval of the New Fontana Agreement is conclusive evidence that Alcoa does not dominate or control Nantahala through that Agreement" and "also bars a determination of either fraud or injustice to Nantahala's customers." Again, the Commission did not, and need not, find "fraud" in the agreements in order to hold Alcoa responsible for the refund obligation. Therefore, we need not address Alcoa's argument that the Commission is preempted from finding fraud in FERC-approved rate schedule. *See also* Part II, A, *supra*. In essence, Alcoa's remaining arguments boil down to the proposition that extensive prior investigation and regulation of the activities of Alcoa and Nantahala by both state and federal regulatory agencies precludes the Commission as a matter of law from finding either domination or injustice in the Alcoa-Nantahala relationship.

In light of the record of Alcoa's repeated and largely successful efforts over the last 40 years to evade, avoid and preclude federal and state regulatory oversight of its subsidiaries' energy producing operations and the various intercorporate power supply agreements between and among them and TVA, we find Alcoa's argument both factually and legally insupportable.[25] Alcoa has failed to demonstrate that any aspect of federal regulatory action with respect to Nantahala and Tapoco preempts the Commission's findings and conclusions with respect to piercing the corporate veil between itself and its public utility subsidiary.[26] It must be remembered that the Commission is charged with the regulation of public service enterprises, which require special State oversight to protect consumers from abuses of their quasi-monopoly power, in order to ensure fairness to the public. N.C. G.S. § 62-2, -30. *Manufacturing Co. v. Aluminum Co.*, 207 N.C. 52, 175 S.E. 2d 698. The Commission's oversight jurisdiction with regard to Nantahala's intrastate retail rates is exclusive, and its determination that Alcoa was legally responsible for Nantahala's excessive intrastate retail rates rests well within the realm of

25. *See* Discussion Part I, B, *supra*.

26. *See* Discussion Part II, A, *supra*.

regulatory control reserved to the states under the Federal Power Act. 16 U.S.C. § 824(b).

In summary, there is ample evidence in the record of Alcoa's financial and managerial control over Nantahala from the time of its inception, and the use of that control to impose upon Nantahala contracts in Alcoa's interest rather than in the interest of Nantahala, amounting to complete domination of policy and business practice "so that the corporate entity as to [these] transaction[s] had at the time no separate mind, will or existence of its own. . . ." *Huski-Bilt*, 271 N.C. at 671, 157 S.E. 2d at 358; *Acceptance Corp.*, 268 N.C. at 9, 149 S.E. 2d at 576. Furthermore, because Alcoa's domination resulted in the sacrifice of a public utility's resources to the needs of a private industrial concern, Alcoa's control may indeed be said to have been used to commit wrong, or to perpetrate the violation of a statutory duty owed Nantahala's customers. *Id.* Finally, the aforesaid control and breach of duty may clearly be said to have proximately caused the injury complained of, *id.*, that is, higher rates for Nantahala's customers. We therefore reject Alcoa's argument that no factual or legal basis exists for the Commission to "pierce the corporate veil" between itself and Nantahala.

d.

In its final arguments concerning the refund obligation, Alcoa maintains (1) that it was "surprised" at being declared a public utility and that it cannot be required to pay refunds based upon Nantahala's overcollections prior to 30 October 1980, the date on which it "became" a public utility; and (2) that the refund obligation is confiscatory.

1.

[23] The mere statement of Alcoa's first contention reveals the underlying fallacy of the argument: Alcoa did not "become" a North Carolina statutory public utility in 1980. This date marks the advent of no new North Carolina law expanding the definition for the first time. Nor does it mark any dramatic change in Alcoa's relationship with its subsidiaries such that the designation "public utility" was *then* appropriate for the first time. Instead, 30 October 1980 merely marks that date of the Commission's determination that, based upon Alcoa's ownership of Nan-

tahala's stock (a fact existing since 1929) and on the basis of the various intercorporate transactions and agreements, dating back at least to 1941, Alcoa satisfied the criteria for public utility status under N.C.G.S. § 62-3(23)c. In essence, Alcoa was found to have been a "public utility" having an effect on Nantahala's rates and service for many years. Based upon this finding, and upon the Commission's findings of detrimental domination, Alcoa can properly be held to pay any refunds Nantahala is ordered to pay in this proceeding, but is unable to satisfy out of its own financial resources. Inasmuch as Alcoa is not asked to pay refunds attributable to any past period (that is, prior to the 1977 rate increase), the concept of retroactive rate making is not implicated by the refund obligation ordered.

2.

[24] We also reject Alcoa's argument that the result of the Commission's order is a confiscation of its property under the rule established in *FPC v. Hope Gas Co.*, 320 U.S. 591, 88 L.Ed. 333 (1944) (the fixing of just and reasonable rates involves a balancing of the investor and the consumer interests; the investor's interests include a rate of return sufficient to produce revenue for operating expenses, service on debt and stock dividends). While it is true that Nantahala has neither supplied Alcoa with power, nor paid a dividend to Alcoa since e[illegible] 1979, these facts do not render the rates established confisca[illegible]y under the circumstances of this case. [illegible]e Commission's order does no more than strike a fair and reasonable balance between the long-neglected interests of Nantahala's customers and the corporate parent whose self-interest has been so long and so well served through intercorporate domination and control. Thus, we find no merit in either the arguments presented by Nantahala or Alcoa with respect to confiscation of their property.

Finally, with respect to Alcoa's liability for Nantahala's refund obligation, we must point out that Alcoa itself has repeatedly undertaken in the past to warrant or otherwise back up its subsidiaries' performance obligations. In both Fontana Agreements, Alcoa warranted that it was backing up or securing the performance of its subsidiaries (including Nantahala) in carrying out the coordination and exchange agreements with TVA. These undertakings by Alcoa certainly undercut Alcoa's intimations that

it was surprised in any manner by being held responsible for the obligations of its wholly-owned subsidiary on the basis of its parental impact upon Nantahala's rates and service.

3.

[25] Nantahala presents one final set of arguments concerning the extent of the refund obligation. First, Nantahala contends that it cannot be required to refund revenue collected prior to 6 March 1979, because this revenue was derived from rates approved by the Commission which were not subject to being refunded prior to the Court of Appeals' reversal of the Commission's approval of the 1977 rates in Docket No. E-13, Sub 29. 6 March 1979 is the filing date of the Court of Appeals decision in *Utilities Comm. v. Edmisten, Atty. General*, 40 N.C. App. 109, 252 S.E. 2d 516, *aff'd in part and rev'd in part*, 299 N.C. 432, 263 S.E. 2d 583. Next, Nantahala contends that if it is responsible for all refunds dating to June 1977; it can only be required to refund the excess of its collected revenue over the revenue allowed in its most recently approved prior rate case, which would be in Docket No. E-13, Sub 23. We find no merit in either of these contentions.

a.

Briefly, by order of the Commission dated 14 June 1977, Nantahala was authorized to put new and increased rates into effect. This order was appealed to the Court of Appeals in the aforementioned case. That court reversed and remanded the order, stating:

> The order of the Commission dated 14 June 1977 authorizing increased rates for Nantahala and approving a new purchased power cost adjustment clause is vacated and set aside.

40 N.C. App. at 119, 252 S.E. 2d at 522. The effect of that decision, if left standing, would have been to require an immediate refund of the increased rate collections as of 6 March 1979. Subsequently, this Court stated:

> The Commission's order of 14 June 1977 authorizing an increase in Nantahala's rates was vacated by the Court of Appeals. The effect of the Court of Appeals' decision was stayed, however, by this Court's issuance of a writ of supersedeas pending the outcome of this appeal. Although

> that writ is hereby dissolved, we believe that essential fairness to all the parties is best served by allowing the increased rates to remain in effect, conditioned upon Nantahala's guarantee that it will in the future *refund to it customers any overcharges should the new rates ultimately be determined excessive*. Accordingly, we reverse the Court of Appeals' setting aside of the order of 14 June 1977 and direct the Commission to obtain adequate assurances of Nantahala's willingness and continued ability *to refund such overcharges as may ultimately result from imposition of the 1977 rate schedule*. (Emphasis added.)

299 N.C. at 444, 263 S.E. 2d at 592.

Upon remand to the Commission, the Commission ordered Nantahala to file an undertaking to refund, stating that:

> [T]he Supreme Court has given this Commission a clear mandate to obtain adequate assurances of Nantahala's willingness and continued ability to refund such overcharges as may ultimately result from the imposition of the 1977 rate schedule. . . .

Thereupon, Nantahala filed an undertaking, wherein Nantahala agreed:

> [T]o refund in a manner to be prescribed by the Commission the amount, if any, found to be owing to its customers should the rates approved by the order of 14 June 1977 be ultimately determined to be excessive. . . .

In its 2 September 1981 Order Reducing Rates and Requiring Refund, the Commission directed Nantahala to make a full and complete refund of all overcollections charged after 14 June 1977, when the higher rates had been put into effect. This order of the Commission is no different in substance from the order to refund overcharges collected under excessive rates which are ultimately disapproved as mandated by our decision in *Utilities Comm. v. Edmisten, Atty. General*, 291 N.C. 451, 232 S.E. 2d 184. In that case, an order of the Commission permitting Duke Power Company (and also CP&L and VEPCO) to collect a surcharge was disapproved on appeal. We stated:

> [T]his matter is remanded to the Court of Appeals for the entry of a judgment by it remanding the matter to the Commis-

> sion for the entry of an order by the Commission vacating its order authorizing the surcharge and directing Duke to make the appropriate refunds to its customers on account of revenues unlawfully collected from them pursuant to the surcharge.

Id. at 474, 232 S.E. 2d at 198.

Nantahala contends that refunds may not be ordered for pre-1979 overcollections because these occurred under rates approved by the Commission on 14 June 1977 which were not subject to any undertaking to refund until 6 March 1979, when the Court of Appeals vacated the 1977 order. Nantahala, relying upon *Utilities Comm. v. City of Durham*, 282 N.C. 308, 193 S.E. 2d 95 (1972), *Utilities Comm. v. Edmisten, Atty. General*, 291 N.C. 451, 232 S.E. 2d 926 and *Utilities Comm. v. Edmisten, Attorney General*, 294 N.C. 598, 242 S.E. 2d 862 (1978), argues that only rates that were imposed unlawfully or were permitted to go into effect, subject to an undertaking to refund, may be refunded. Nantahala further contends that because the subject rates were initially approved by the Commission, they are automatically deemed "just and reasonable" under N.C.G.S. § 62-132; therefore, they cannot be considered "unlawful" for purposes of requiring a refund at a later date. This, Nantahala contends, would constitute "retroactive" rate making, in excess of the Commission's authority, because N.C.G.S. § 62-132 permits the Commission to award refunds only where rates that it *allows* to go into effect, as opposed to rates which it *approves*, are later determined to be unreasonable. Next, Nantahala argues that it did not execute an undertaking to refund regarding the 1977 rates until after 6 March 1979, so that only overcollections after that date may be refunded under the line of cases cited above.

Nantahala's argument, although not without logical appeal, confuses the issue with respect to the refund ordered in this case. As Nantahala itself observed in its brief, both *Edmisten* cases cited above discussed the authority of the Commission under N.C.G.S. § 62-132[27] to award refunds to rate payers, where a utility collects rates *different and higher than those approved by the Commission.* This statute and the cases cited by Nantahala have no applicability to the situation under discussion. Here, excessive rates, initially but erroneously approved by the Commission, were permitted to remain in effect pending the ultimate resolution of the contested factual issue concerning the appropriate rate making methodology to utilize when fixing Nantahala's retail rates. N.C.G.S. § 62-132 cannot be relied upon to transmute an excessive rate into a "just and reasonable" rate by virtue of labeling such rates as rates "established by the Commission." Therefore, the distinction recognized under that statute with respect to the need for an undertaking to refund before refunds may be ordered on the basis of revenue collected under "established" rates has absolutely no bearing on the extent of Nantahala's refund obligation.

27. N.C.G.S. § 62-132 provides:

The rates established under this Chapter by the Commission shall be deemed just and reasonable, and any rate charged by any public utility different from those so established shall be deemed unjust and unreasonable. Provided, however, that upon petition filed by any interested person, and a hearing thereon, if the Commission shall find the rates or charges collected to be other than the rates established by the Commission, and to be unjust, unreasonable, discriminatory or preferential, the Commission may enter an order awarding such petitioner and all other persons in the same class a sum equal to the difference between such unjust, unreasonable, discriminatory or preferential rates or charges and the rates or charges found by the Commission to be just and reasonable, nondiscriminatory and nonpreferential, to the extent that such rates or charges were collected within two years prior to the filing of such petition.

Moreover, it is elementary that the Commission's approval of any rate is always subject to judicial review. It is equally well-settled that rates or charges fixed by an order of the Commission are to be considered just and reasonable unless and until they are changed or modified on appeal or by the further action of the Commission itself. *In re Utilities Co.*, 179 N.C. 151, 101 S.E. 619 (1919). *See also R.R. v. R.R.*, 173 N.C. 413, 92 S.E. 150 (1917). Thus, the 1977 rates were only *presumed* to have been lawfully approved by the Commission until the 1977 order was reviewed by our appellate courts. When, upon appellate review *and* further action by the Commission itself, the 1977 rates were determined to be excessive, Nantahala's rate payers became entitled to recover *all* overcharges collected pursuant thereto. The various dates upon which appellate decisions were entered in this case have ab-

solutely no bearing upon the temporal extent of Nantahala's refund obligation.

The premise underlying such a refund obligation is that rates which are found to be excessive are then *considered* to have been illegal from the outset, and are not considered to have become illegal only as of the date on which the appellate court has found them to be so. *See Louisville & N. R. Co. v. Greenbriar Distillery Co.*, 170 Ky. 775, 187 S.W. 296 (1916). The Commission's order with respect to the temporal extent of the refund obligation is, therefore, compatible with the mandate of this Court in *Edmisten*, and well within the Commission's inherent authority to order a public utility to refund monies which were overcollected from its customers under excessive and unlawful rates. *See* N.C.G.S. §§ 62-30, -130; -13?; *Utilities Comm. v. Edmisten, Atty. General*, 291 N.C. 451, 232 S.E. 2d 184.

In answer to the additional point raised by Nantahala in this regard, we hold that the concept of "retroactive rate making" has no application in the instant proceeding. The rates ultimately fixed and the refund ordered by the Commission in the Sub 29 (Remanded) proceeding were not collectible for past service, but for service rendered in the locked-in period of this docket.

b.

[26] Finally, Nantahala challenges the Commission's action in measuring the excess revenue collected by the rates set under the roll-in rather than upon any excess revenue collected over and above what would have been collected under Nantahala's prior rate schedule, established in Docket No. E-13, Sub 23. While it is true that the rates ultimately established by the Commission in the Sub 29 (Remanded) proceeding were actually lower than the rates which Nantahala had in effect prior to 14 June 1977 by virtue of its earlier rate case (Sub 23), this fact is irrelevant to the amount of excess revenues which Nantahala's customers are entitled to receive under the rates properly established in the Sub 29 (Remanded) proceeding.

The Sub 23 rates were effectively superseded by the 1977 rates. Had the Court of Appeals decision in the original appeal from the Sub 29 proceeding been permitted to stand without appeal, the effect would have been dismissal of the Sub 29 rate in-

crease request and the Sub 23 rates would, indeed, have been effectively reinstated. However, when this Court permitted the 1977 rates to remain in effect, and remanded the case for further consideration, the Sub 29 proceeding was effectively continued until such time as the Commission modified its 14 June 1977 order and reduced Nantahala's rates. At no point in time were the Sub 23 rates "resurrected." Therefore, its refund obligation may not be measured against Nantahala's earlier, superseded rates, but must be calculated on the basis of overcharges actually levied and collected from the retail rate payers during the entire 1977-1981 period.

D.

[27] Finally, both Alcoa and Nantahala challenge the Commission's order on the grounds that the Commission failed to make independent findings of fact as to the propriety of the roll-in device in fixing Nantahala's rates. The companies primarily base their argument on certain phrases contained in the Commission's 2 September 1981 order referring to statements contained in this Court's opinion in *Edmisten*, 299 N.C. 432, 263 S.E. 2d 583, as "findings." Nantahala contends that the Commission has thereby shown that it has either improperly taken this Court's observations or concerns as facts binding upon it or has chosen to disregard substantial quantities of evidence that roll-in is inappropriate and that the NFA and 1971 Apportionment Agreement do not convey hidden benefits to Alcoa. Alcoa approaches the issue somewhat differently. It contends that the remanded hearings as to its status and liability for the refund obligation was not truly "*de novo*" because the Commission accorded an improper presumption of validity to findings made in the prior Sub 29 hearing and to purported "findings" contained in our decision in *Edmisten*. Alcoa argues that the effect of this was to improperly shift the burden of proof onto Alcoa to rebut or disprove findings established in a case to which Alcoa was not then a party, in violation of Alcoa's due process right to be heard on all issues affecting it.

Although we fully agree with the Court of Appeals that the Commission's use of such phraseology is "unfortunate," we completely reject the companies' arguments that the findings actually made by the Commission on all issues addressed in the remanded

proceedings were anything less than fully independent and fully supported by substantial, if not overwhelming, evidence of record. In *Edmisten*, we remanded the matter to the Commission for the purpose of considering the propriety of treating Nantahala and Tapoco as a single utility enterprise and determining whether Nantahala's customers would benefit by application of a rolled-in rate making methodology. As we indicated in Part I, A of this opinion, our discussion of these factual issues was limited to the purposes of demonstrating the legal basis for reversal of the 1977 order—failure to accord more than minimal consideration to material facts of record bearing upon the determination of reasonable rates for Nantahala—and the legal significance of evidence indicating that Nantahala had structured its economic affairs so as to afford an unfair preference to its parent Alcoa at the detriment of its intrastate retail rate payers.

This Court in *Edmisten* did not, as it indeed could not, "find facts"; that duty is imposed solely on the Commission. N.C.G.S. § 62-94; *Utilities Comm. v. Coach Co.*, 260 N.C. 43, 132 S.E. 2d 249 (1963). In addition, the weight of the evidence presented is also for the Commission, and not the court, to decide. *Utilities Comm. v. City of Durham*, 282 N.C. 308, 193 S.E. 2d 95. Even a cursory reading of the 1981 order shows that the Commission's references to this Court's opinion are included in an evident effort to demonstrate that, upon remand, and in keeping with the directive of this Court, adequate consideration was given to the material facts of record highlighted by this Court in its opinion. Moreover, the clearest proof of the Commission's exercise of its independent judgment in gathering and weighing evidence that dealt with the roll-in question and the issue of Alcoa's liability for its subsidiary's refund lies in the extensive and detailed discussion of the Evidence and Conclusions for Findings of Fact Nos. 4, 5, 6, 7 and 21. This discussion embraces almost one-fourth of the nearly sixty page order reducing rates and ordering refund payments. It is clearly based upon the many volumes of testimony taken and scores of exhibits received upon remand, and not upon any observations of this Court.

Nantahala's argument concerning the Commission's factual findings amounts to little more than a disagreement with the *result* reached by the Commission as to whether a roll-in should be performed and which jurisdictional cost allocation methodology

would most accurately reflect the cost of service attributable to Nantahala's intrastate retail customers. Although there was evidence of record which would perhaps support the position taken by Nantahala with respect to the roll-in, that does not entitle Nantahala to a reversal of the order. The test upon appeal from a determination of the Commission is whether the Commission's findings of fact are supported by competent, material and substantial evidence in view of the entire record. N.C.G.S. § 62-94 (b)(5). Nantahala does not even attempt to argue that the challenged findings are not supported by substantial evidence and we have no difficulty in holding that they are. Nantahala merely argues that the Commission has "ignored" evidence to the contrary.

Although the Commission must consider and determine controverted questions by making findings of fact and conclusions of law, and set forth the reasons and bases therefor "upon all the material issues of fact, law, or discretion," N.C.G.S. § 62-79(a)(1), it need not comment upon every single fact or item of evidence presented by the parties. Accordingly, we find no merit in any of Nantahala's arguments concerning the findings of fact supporting the Commission's rate reduction and refund order. Rather, we conclude that the Commission, after careful consideration of all the evidence presented upon remand, adequately weighed and discussed all the material issues of fact raised thereby and properly reached its own independent decision as to the propriety of and necessity for the roll-in and the method for implementing it.

Alcoa's argument that the Commission denied it a fair hearing by relying on "fact finding" by this Court and findings made by the Commission in the Sub 29 hearing is based almost exclusively on a single paragraph in the Commission's order, which states:

> These findings by the Supreme Court, that Nantahala and Tapoco constitute a single, integrated electric system and should be treated as one system for rate-maing purpose [sic], have been carefully considered by the Commission for purposes of this proceeding. However, since Alcoa and Tapoco were not parties to the original proceeding that led to the June 14, 1977 Order, the Commission has allowed them and Nantahala to introduce evidence in the remand proceeding to challenge the findings of the Supreme Court.

Alcoa argues that the foregoing statement indicates that the Commission improperly shifted the burden of proof and that its requirement that Alcoa disprove "findings" from a prior hearing at which it was not even present influenced the Commission's ultimate determinations concerning Alcoa's liability. Alcoa reasons that had it been accorded a proper *de novo* hearing, the result could well have been different; therefore, the Commission's order should be reversed. We do not agree.

The paragraph relied upon by Alcoa in its argument follows a discussion by the Commission of certain conclusions by this Court in *Edmisten* as to the existence, sufficiency, and legal significance of evidence adduced in the Sub 29 proceeding which indicated that Nantahala and Tapoco were designed and operated as a single system and ought therefore, be treated as such for rate making purposes under a roll-in device or methodology. Immediately following the quoted paragraph is a lengthy recital of the evidence supporting the Commission's conclusion that the Nantahala and Tapoco electric facilities *do* constitute a single, integrated system, are operated as such and are coordinated as such with the TVA system, and its further conclusion that the two companies' financial data should be rolled-in for rate making purposes as this would benefit Nantahala's customers. The mere fact that the Commission's ultimate findings and conclusions regarding the roll-in are consonant with this Court's earlier discussion of certain aspects of the original evidence does not invalidate the entire Sub 29 (Remanded) proceedings or order. Nothing in the record before us indicates that the Commission improperly placed a burden on Alcoa, or otherwise denied it a fair hearing. In fact, at the remanded hearing, the Commission permitted all participants the right to present any appropriate evidence on the relevant issues and to cross-examine all witnesses. The Commission never stated that Alcoa had "failed to rebut" any presumptions or to carry any particular "burden of proof," and the evidence was more than sufficient for the Commission to have reached the conclusion that it did as to Alcoa's liability without the benefit of any presumptions or other procedural devices. Under the circumstances of this case, the Commission's unfortunate use of the phrase "findings by the Supreme Court" does not itself warrant reversal of the Commission's order.

We also reject Alcoa's argument that it did not receive a true *de novo* hearing on all issues affecting its status and liability as a statutory public utility and that this constitutes reversible error. The record reveals that upon remand, the Commission recognized the right of both Tapoco and Alcoa to be heard *de novo* on such issues as affected them and upon which they desired *de novo* consideration of evidence. Specifically, the Commission ordered:

> Tapoco and Alcoa are entitled to be heard, *de novo* on the prior record compiled in the proceeding, but only as the further consideration of such evidence affects them. Such *de novo* hearing includes cross-examination and the right to offer evidence on their own behalf which addresses matters previously addressed. Since the prior record in this case is lengthy, and since many of the issues already determined will not affect Tapoco and Alcoa, it will be incumbent upon the Respondents to specify in advance of the hearing the issues on which they desire to be heard. The Commission can appreciate that until the Intervenors and Public Staff have stated their positions, Respondents may not know on what issues they desire to be heard *de novo*. The Commission may schedule a pre-hearing conference after all direct testimony has been prefiled in order to resolve some of these problems.

During the remanded hearings, the Commission accepted various portions of the original hearing without change by any party, such as the capital structure, embedded cost of debt, proper equity, and overall rates of return established for Nantahala in the 14 June 1977 order. No party offered any evidence upon those aspects of the case. However, as to the contested issues of public utility status, the propriety of the roll-in and the jurisdictional cost allocation method to be used, all parties, including Nantahala, Alcoa and Tapoco, were permitted to present such evidence as they desired.

All three companies, Nantahala, Alcoa and Tapoco, introduced testimony and extensively cross-examined the intervenors' witnesses. At no time did the Commission deny a request by Alcoa or Tapoco to put on evidence or cross-examine witnesses from the first set of hearings with respect to particular facts. Although not expressly directed to do so by this Court, the Com-

mission in effect afforded all parties a *de novo* hearing with respect to *any issue* properly raised by them. In every material respect, the remanded proceedings were conducted as *de novo* hearings on both the jurisdictional and substantive issues involved in this case. Any matters not expressly redetermined from the original hearing were matters which were not in controversy and which were, if anything, favorable to Nantahala, and therefore, to Alcoa. Accordingly, we reject Alcoa's assertion that the "hearing below was an arbitrary and capricious drama," in which its due process right to be heard on all issues affecting it was not respected. To the contrary, we conclude that all parties received a full and fair hearing at all stages of the original and remanded proceedings and that the Commission's order was, in all respects, based upon fully independent and well substantiated findings of fact and conclusions of law.

III.

We have carefully reviewed the lengthy record compiled in this proceeding, the many and complex arguments presented by the parties and the amici curiae, and the relevant authorities cited by the parties in their briefs and those later submitted to this Court as additional authority. For the reasons stated in Parts I and II of this opinion, we conclude that the Utilities Commission has properly decided all factual and discretionary issues related to the roll-in, rate reduction and refund obligation based upon competent, relevant and substantial evidence in view of the entire record. We further conclude that the order reducing rates and requiring refunds for Nantahala's intrastate retail rate payers is free from any statutory or constitutional infirmity.

Specifically, we hold that: (1) the Commission correctly determined that Tapoco is a public utility in North Carolina, subject to its regulatory authority and jurisdiction; (2) the Commission's order has in no way contravened the terms and conditions of Tapoco's federal license to operate hydroelectric plants in North Carolina and Tennessee and the Commission is not, therefore, preempted from implementing the roll-in by virtue of Part I of the Federal Power Act and the Supremacy Clause of the United States Constitution; (3) the Commission properly determined that a roll-in for rate making purposes was mandated in the case of Nantahala and Tapoco on the grounds that (a) Nantahala has

not been designed, developed and operated as a stand-alone electric system, (b) the Nantahala and Tapoco electric facilities constitute a single integrated electric system, and (c) the two corporate affiliates should be treated as a single utility system for rate making purposes, in view of their historical development, actual operating conditions and the fact that Nantahala's customer cost responsibility cannot be accurately determined using a "stand-alone" model; (4) the Commission correctly determined that Alcoa is a North Carolina public utility under the provisions of N.C.G.S. § 62-3(23)c by virtue of the substantial and ultimately detrimental impact Alcoa's affiliation has had upon Nantahala's rates; (5) the roll-in methodology utilized by the Commission is not barred under the Supremacy Clause of the United States Constitution (a) either by virtue of Part II of the Federal Power Act or (b) by virtue of federal regulatory action in a parallel wholesale rate case; (6) utilization of the roll-in does not grant a preference to Nantahala's North Carolina customers and does not impermissibly interfere with interstate commerce in violation of the Commerce Clause of the United States Constitution; (7) application of the roll-in methodology as developed by the Commission, with its resulting reduction in retail rates and refund obligation, does not impermissibly impair Nantahala's ability to earn a proper rate of return on its investment and does not amount to a confiscation of its properties; (8) the Commission acted well within its regulatory and rate making authority in imposing the obligation upon Nantahala's parent Alcoa to pay any portion of the refund obligation for the entire locked-in period of Docket No. E-13, Sub 29 (Remanded) as Nantahala is financially unable to make; (9) prior federal and state regulation of Nantahala and Alcoa, the various transactions and the agreements affecting Nantahala's power supply does not prohibit or preempt the Commission from piercing the corporate veil between Alcoa and its wholly-owned subsidiary to hold Alcoa financially responsible for Nantahala's refund obligation; (10) the results obtained under the roll-in do not amount to a confiscation of Alcoa's property; (11) the Commission properly ordered Nantahala to refund to its North Carolina retail customers all revenue collected under the rates approved by the Commission Order issued 14 June 1977, to the extent that said rates produced revenue in excess of the level of rates approved in the Sub 29 (Remanded) proceedings and Order issued 2 September 1981; and (12) all parties received a full and fair hearing at all

stages of the original and remanded proceedings and the Commission's order is, in all respects, based upon fully independent and well substantiated findings of fact and conclusions of law.

For the foregoing reasons, the decision of the Court of Appeals upholding the Commission's order reducing Nantahala's retail rates and requiring refunds to its North Carolina retail customers is

Affirmed.

Justice VAUGHN did not participate in the consideration or decision of this case.

STATE OF NORTH CAROLINA, EX REL. UTILITIES COMMISSION v. NANTAHALA POWER AND LIGHT COMPANY; ALUMINUM COMPANY OF AMERICA; AND TAPOCO, INC.	ORDER

No. 227A83

(Filed 16 July 1985)

NANTAHALA Power and Light Company's (hereinafter "Nantahala") Motion for Writ of Supersedeas filed herein on 17 July 1985 is DENIED.

The orders of the North Carolina Utilities Commission, affirmed by this Court on 3 July 1985, requiring Nantahala to make refund payments to its customers are temporarily stayed to and including the 31st day of July 1985 but no longer. The temporary stay allowed by this order will expire automatically at 12:01 a.m. on 1 August 1985 without the necessity of any further order by this Court. The purpose of the stay is to permit Nantahala to seek a writ of certiorari and stay from the United States Supreme Court.

By order of the Court in Conference, this 18th day of July 1985.

MITCHELL, J.
For the Court

STATE OF NORTH CAROLINA, EX REL. UTILITIES COMMISSION v. NANTAHALA POWER AND LIGHT COMPANY; ALUMINUM COMPANY OF AMERICA; AND TAPOCO, INC.	)	ORDER

No. 227A83

(Filed 18 July 1985)

THE Aluminum Company of America's (hereinafter "Alcoa") Petition for Writ of Supersedeas filed herein on 12 July 1985 is DENIED.

The orders of the North Carolina Utilities Commission, affirmed by this Court on 3 July 1985, requiring Alcoa to assist in the making of refund payments to customers of Nantahala Power and Light Company are temporarily stayed to and including the 31st day of July 1985 but no longer. The temporary stay allowed by this order will expire automatically at 12:01 a.m. on 1 August 1985 without the necessity of any further order by this Court. The purpose of the stay is to permit Alcoa to seek a writ of certiorari and stay from the United States Supreme Court.

The stay granted herein is conditioned upon the filing with this Court of confirmation by the Aluminum Company of America and Federal Insurance Company that the Bond (Bond No. 80965200) dated 8 February 1984 and filed in this cause on 9 February 1984 remains in full force and effect during the pendency of the stay herein granted.

By order of the Court in Conference, this 16th day of July 1985.

MITCHELL, J.
For the Court

APPENDIX B

Opinion Of The North Carolina Court of Appeals

In my opinion the dismissal by the trial court was correct and my vote is to affirm it.

STATE OF NORTH CAROLINA, EX REL. UTILITIES COMMISSION; RUFUS L. EDMISTEN, ATTORNEY GENERAL; PUBLIC STAFF; HENRY J. TRUETT; TOWN OF BRYSON CITY; SWAIN COUNTY BOARD OF COUNTY COMMISSIONERS; CHEROKEE, GRAHAM AND JACKSON COUNTIES, THE TOWNS OF ANDREWS, DILLSBORO, ROBBINSVILLE, AND SYLVA; THE TRIBAL COUNCIL OF THE EASTERN BAND OF CHEROKEE INDIANS; MURIEL MANEY; AND DEROL CRISP v. NANTAHALA POWER AND LIGHT COMPANY; ALUMINUM COMPANY OF AMERICA; AND TAPOCO, INC.

No. 8210UC1034

(Filed 6 December 1983)

1. Electricity § 3; Utilities Commission § 36— electric rates—affiliated utilities—use of energy generated by unified system rather than entitlements under agreements

Where the Utilities Commission found that Nantahala Power Co. and Tapoco, Inc. should be treated as one utility for ratemaking purposes, and where Nantahala, Tapoco, TVA and Alcoa had entered into agreements approved by the Federal Energy Regulatory Commission under which all power generated by Nantahala and Tapoco is to be delivered to TVA, certain annual demand and energy entitlements are granted to Nantahala and Tapoco, and Alcoa, Nantahala and Tapoco are to decide how the power will be divided between Nantahala and Tapoco, the Utilities Commission's use of the amount of energy generated by the unified system in setting Nantahala's rates to its retail customers rather than the energy received as entitlements under the agreements with TVA, Alcoa and Tapoco did not constitute a modification of such agreements and was proper.

2. Electricity § 3; Utilities Commission § 36— electric rates—affiliated utilities—costs of energy—no violation of Commerce Clause

The Utilities Commission's method of determining the retail rates of Nantahala Power Co. on the basis of its percentage of the costs of the energy generated and purchased by the combined Nantahala-Tapoco system did not shift a portion of Nantahala's costs to its Tennessee customers in violation of the Commerce Clause of the U.S. Constitution. Art. I, § 8 of the U.S. Constitution.

3. Electricity § 3; Utilities Commission § 57— independent finding by Utilities Commission—sufficiency of evidence

The Utilities Commission made an independent finding of fact not based on a prior Supreme Court decision in the case that energy demand and entitlement agreements entered into by Nantahala Power Co., Tapoco, Inc., TVA and

Alcoa resulted in substantial benefits to Alcoa to the detriment of Nantahala's customers, and such finding was supported by the evidence at a rate hearing although there was contrary evidence tending to show that the agreements were fair to Nantahala.

4. Electricity § 3; Utilities Commission § 36— electric rates—affiliated companies—method of roll-in of properties, revenues and expenses

The Utilities Commission was not required by a Supreme Court opinion remanding this case to adopt a method of rolling in the properties, revenues and expenses of Tapoco, Inc. with those of Nantahala Power Co. which acknowledged apportionment agreements entered by Nantahala, Tapoco, TVA and Alcoa as controlling the allocation of costs and benefits in determining Nantahala's retail rates. Nor was the Commission required to make a distinction between firm power and curtailable power.

5. Electricity § 3; Utilities Commission § 36— electric rates—affiliated utilities—roll-in of properties, revenues and expenses—failure to include power purchased by parent company

The Utilities Commission's roll-in of the properties, revenues and expenses of Tapoco, Inc. with those of Nantahala Power Co. for the purpose of determining Nantahala's retail rates was not erroneous because it included the power which Nantahala purchased from TVA but did not include the power which its parent company, Alcoa, purchased from TVA.

6. Utilities Commission § 5— parent corporation as public utility—constitutionality of statute

The statute providing for the imposition of public utility status on certain parent corporations, G.S. 62-3(23), is not void for vagueness, since a person of ordinary understanding would know from reading the statute that if a parent corporation controls its wholly owned public utility in such a way that the rates of the utility are affected, this has an effect on the rates and the parent corporation could be found to be a public utility.

7. Utilities Commission § 5— parent corporation as public utility—no delegation of legislative power

The statute providing for the imposition of public utility status on certain parent corporations, G.S. 62-3(23), does not delegate legislative power to the Utilities Commission in violation of Art. I, § 6 of the N.C. Constitution, since the legislature has given the Utilities Commission sufficient guidelines so that if the facts are properly found by the Commission, it does not make policy but carries out legislative policy.

8. Electricity § 3; Utilities Commission § 36— extent of affiliation on rates—sufficiency of finding

A finding by the Utilities Commission that "Alcoa has so dominated certain transactions and agreements affecting its wholly owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone the interest of its public utility customers in North Carolina" was a sufficient finding as to the extent Alcoa's affiliation with Nantahala had affected the rates of Nantahala within the purview of G.S. 62-3(23)c

so as to support the Commission's order that Alcoa must pay any portion of refunds to Nantahala's customers which Nantahala is financially unable to pay.

9. **Electricity § 3; Utilities Commission § 36— electric rates—responsibility of parent corporation for refunds—no retroactive ratemaking**

A Utilities Commission order requiring Alcoa to be responsible for a refund to customers of Nantahala Power Co. for a period of time prior to the time Alcoa was held to be a public utility did not constitute retroactive ratemaking.

10. **Electricity § 1; Utilities Commission § 5— Tapoco, Inc. as public utility**

The Utilities Commission properly found that Tapoco, Inc. is a public utility where the evidence showed that electricity generated by Tapoco is exchanged with TVA for power from TVA, since this constitutes furnishing electricity to TVA for distribution to the public within the meaning of G.S. 62-3(23)b.

11. **Electricity § 3; Utilities Commission § 36— electric rates—affiliated utilities—single electric system**

The Utilities Commission properly found that Nantahala Power Co. and Tapoco, Inc. constitute a single integrated electric system operated as a coordinated part of the TVA system where the evidence showed that the two companies traded all their generation to TVA and received from TVA entitlements to energy which they divide as they please.

12. **Electricity § 3; Utilities Commission § 47— general rate case—notice to parent of possible responsibility for subsidiary's refunds**

When Alcoa was held to be a public utility and was made a party to a general rate case, it received adequate notice that it might be held liable for a refund to retail customers of its wholly owned subsidiary, Nantahala Power Co.

13. **Utilities Commission § 44— general rate case—prefiling of testimony—time for filing brief**

The due process rights of Alcoa in a general rate case involving its wholly owned subsidiary, Nantahala Power Co., were not violated by the Utilities Commission's requirement that Alcoa prefile its testimony prior to the prefiling of the intervenors' testimony and that Alcoa file its brief concurrently with that of the intervenors.

14. **Utilities Commission § 36— electric rates—finding concerning affiliated companies—no shifting of burden of proof**

Although the Utilities Commission stated in its rate order that it had permitted Alcoa to introduce evidence "to challenge the findings of the Supreme Court" in a prior appeal of the case that Nantahala Power Co. and Tapoco, Inc. constituted a single electric system for ratemaking purposes, the Commission did not improperly shift the burden of proof to Alcoa where there was sufficient evidence to support the Commission's finding that Nantahala and Tapoco constituted a single system for ratemaking purposes without the use of any presumption against Alcoa.

15. **Electricity § 3; Utilities Commission § 36— electric rates—responsibility of parent for subsidiary's refunds—general rate case**

A proceeding in which the Utilities Commission found Alcoa to be a public utility and ordered Alcoa to pay any portions of refunds which its wholly owned subsidiary, Nantahala Power Co., is financially unable to pay was properly conducted as a general rate case rather than as a complaint proceeding against Alcoa, since the responsibility of Alcoa for Nantahala's refund was ancillary to the case.

16. **Electricity § 3; Utilities Commission § 56— electric rates—order for refunds—compliance with prior Supreme Court decision**

The Utilities Commission was following the mandate of the N.C. Supreme Court in a prior appeal of this case in ordering Nantahala Power Co. to "refund to its North Carolina retail customers all revenue collected under the rates approved by the Commission order issued June 14, 1977, to the extent that said rates produce revenue in excess of the rates approved herein."

17. **Electricity § 3; Utilities Commission § 36— electric rates—order requiring refunds—no confiscation of property**

A Utilities Commission order providing for refunds to Nantahala Power Company's retail customers and requiring Nantahala's parent company, Alcoa, to pay any portion of the refunds which Nantahala is financially unable to pay did not confiscate the property of Nantahala in violation of its due process rights because Nantahala's refund obligation is more than its net worth, Alcoa has denied its obligation to pay, and it may be years before Alcoa has exhausted its remedies in federal court.

APPEAL by respondents from order of North Carolina Utilities Commission entered 2 September 1981. Heard in the Court of Appeals 25 August 1983.

This is an appeal from an order by the North Carolina Utilities Commission reducing rates and requiring a refund by Nantahala Power and Light Company and Alcoa. This case has previously been in the appellate courts. *See Utilities Comm. v. Edmisten, Attorney General*, 40 N.C. App. 109, 252 S.E. 2d 516 (1979), *aff'd in part and rev'd in part*, 299 N.C. 432, 263 S.E. 2d 583 (1980). Nantahala and Tapoco, Inc. are wholly owned subsidiaries of the Aluminum Company of America (Alcoa). Each of them is engaged in the generation of hydroelectric power in western North Carolina. Tapoco sells power to no one but Alcoa for the use of its aluminum manufacturing operations in Tennessee. Nantahala, which was organized in 1929, served the public until 1941 with a small amount of its power going to Alcoa. In 1941 with the advent of World War II, Nantahala accelerated the development

of its hydroelectric power to serve Alcoa's increased production of aluminum for the war effort. After the war, Alcoa continued buying power from Nantahala but the expanded demand by the public took increasing amounts of Nantahala's generation so that after 1971 Alcoa has not taken any power from Nantahala.

In 1941 Nantahala and Tapoco entered into an agreement with the Tennessee Valley Authority (TVA) known as the Fontana Agreement. Among other things, this agreement provided that the TVA would coordinate the water flow of the dams owned by Nantahala and Tapoco. The agreement was to last for 20 years. In 1962 the Fontana Agreement was replaced by the New Fontana Agreement (NFA). TVA, Alcoa, Nantahala and Tapoco are parties to the NFA. Under the terms of the NFA, all power generated by Nantahala and Tapoco is delivered to TVA. TVA grants to Nantahala and Tapoco annual entitlements to some 1,798,000,000 kwh. The NFA provides that Alcoa, Nantahala and Tapoco will decide how the power will be divided between Nantahala and Tapoco.

In 1963 an agreement was made by the three parties under the terms of which Nantahala was to receive as its monthly share of the NFA entitlements the larger of either its total actual generation or 30,000,000 kwh. This agreement provided further that Alcoa was to pay Nantahala an annual sum of $89,200 in compensation for allowing TVA to control the flow of water through Nantahala's dams.

In 1971 a new apportionment agreement was made. Under this agreement Nantahala received 360 million kwh annually. The $89,200 annual payment from Alcoa was eliminated and Nantahala purchased from TVA any additional power it needed for its customers. In 1975, the test year for this case, Nantahala purchased slightly more than 90 million kwh from TVA for which it paid over $1.5 million dollars. Nantahala generated in excess of 520 million kwh in that year.

The Utilities Commission first refused to join Alcoa and Tapoco as parties and denied a motion to compel Nantahala to produce information sufficient to allow the Commission to consider a rate design based on the "rolling in" of Tapoco's properties, revenues and expenses with those of Nantahala, as though the two were operating as one utility. This Court reversed. Our

Supreme Court affirmed in part the decision of this Court and ordered the case remanded to the Utilities Commission with directions that it consider whether a rate schedule computed as if Nantahala and Tapoco were one utility would be in the best interests of the customers of Nantahala.

After the remand from the Supreme Court, the Utilities Commission held further hearings. Alcoa and Tapoco were made parties to the proceedings and were held to be public utilities. The Commission found that the NFA and the 1971 Apportionment Agreement have resulted in substantial benefits to Alcoa to the significant detriment of the retail customers of Nantahala, and that the Nantahala and Tapoco systems should be treated as one entity with respect to all matters affecting the determination of Nantahala's reasonable cost of service applicable to its North Carolina retail operations.

In calculating the costs of power to Nantahala's retail customers, the Utilities Commission did not use the NFA or 1971 Apportionment Agreement. It used instead the total generation of Nantahala and Tapoco plus the power purchased from TVA by Nantahala. It allocated Nantahala's share of demand related costs by dividing the total dependable capacity of the two systems plus the power purchased from TVA into Nantahala's peak load during the test year. The result was 24.60% which the Commission assigned to Nantahala as its percent of the total system demand costs. It calculated Nantahala's share of energy related costs by dividing total average energy available from the unified system plus Nantahala's purchase from TVA into Nantahala's energy requirements for 1975. This gave a result of 24.51% which the Commission assigned to Nantahala as its share of energy costs for the unified system.

The Commission ordered that Nantahala reduce its rates and refund to its North Carolina retail customers all revenue collected under the Commission's order issued 14 June 1977 to the extent said rates produced revenue in excess of the rates allowed by the Commission in this proceeding. It ordered further that to the extent Nantahala is financially unable to make the refunds required in the Commission's order, Alcoa shall make such refunds.

Alcoa, Nantahala and Tapoco appealed.

Attorney General Edmisten, by Assistant Attorney General Richard L. Griffin, for the State.

Crisp, Davis, Schwentker and Page, by William T. Crisp and Robert B. Schwentker, for Henry J. Truett, the Counties of Cherokee, Graham, Swain, and Jackson; the Towns of Andrews, Dillsboro, Robbinsville, Bryson City and Sylva; and the Tribal Council of the Eastern Band of the Cherokee Indians.

Robert Fischbach, Executive Director of The Public Staff, by Staff Attorney Thomas K. Austin, for the Using and Consuming Public.

Joseph A. Pachnowski for the Town of Bryson City.

Western North Carolina Legal Services, Indian Law Unit, by Larry Nestler, for Muriel Maney and Derol Crisp.

Fred H. Moody, Jr. for the County of Swain.

Hunton and Williams, by Robert C. Howison, Jr., James E. Tucker, Edward S. Finley, Jr., and William C. Matthews, Jr., for Nantahala Power and Light Company.

LeBoeuf, Lamb, Leiby and MacRae, by Ronald D. Jones and David R. Poe, for Aluminum Company of America and Tapoco, Inc.

WEBB, Judge.

[1] Nantahala and Tapoco first attack the methodology used by the Utilities Commission in establishing the charge to Nantahala's retail customers. They argue that the Commission is required by law to recognize the NFA and the 1971 Apportionment Agreement in setting rates for Nantahala's retail customers. They say this is so because both of these agreements have been filed with and approved by the Federal Energy Regulatory Commission (FERC) and the Utilities Commission is preempted by federal law from ignoring them. The Utilities Commission in setting retail rates has to give effect to wholesale rates established by the FERC. *See F.P.C. v. Southern California Edison Co.*, 376 U.S. 205, 84 S.Ct. 644, 11 L.Ed. 2d 638, *reh'g denied, F.P.C. v. Southern California Edison Co.*, 377 U.S. 913, 84 S.Ct. 1161, 12 L.Ed. 2d 183 (1964); *Public Service Co. of Colorado v. P.U.C. of Colorado*, 644 P.

2d 933 (Colo. 1982); *People's Counsel of D.C. v. P.S.C. of D.C.*, 444 A. 2d 975 (D.C. Ct. App. 1982); *Northern States Power Co. v. Hagen*, 314 N.W. 2d 32 (N.D. 1981); *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A. 2d 1358 (1977), *cert. denied, Burke v. Narragansett Electric Co.*, 435 U.S. 972, 98 S.Ct. 1614, 56 L.Ed. 2d 63 (1978); *Citizens Gas Users Ass'n. v. Public Utilities Comm.*, 165 Ohio St. 536, 138 N.E. 2d 383 (1956); *City of Chicago v. Illinois Commerce Comm.*, 13 Ill. 2d 607, 150 N.E. 2d 776 (1958); and *United Gas Corp. v. Mississippi P.S.C.*, 240 Miss. 405, 127 So. 2d 404 (1961). Nantahala and Tapoco contend that when the Utilities Commission, in setting retail rates for Nantahala, refused to use the demand and energy entitlements which Nantahala received under the NFA and the 1971 Apportionment Agreement, the Commission modified these two agreements which it does not have the power to do.

We believe the resolution of this case largely depends on a proper analysis of the NFA and the 1971 Apportionment Agreement as affected by the order of the Utilities Commission. The Commission's order does not change the energy entitlements received by Nantahala and Tapoco under the NFA and the 1971 Apportionment Agreement. Each receives its share of the power and uses it as received. The question is whether by not using these two agreements in setting Nantahala's rates the Utilities Commission has changed the agreements, which it does not have the power to do.

When the Utilities Commission determined that Nantahala and Tapoco should be treated as one company for rate-making purposes, it was faced with the question of what constituted a proper charge to Nantahala's retail customers for the power used by them. The Utilities Commission resolved this question by assigning to Nantahala's retail customers a demand charge based on the percentage used by Nantahala of the firm energy generated and purchased by the unified system during the test year. It calculated the energy charge using the same method, that is, it assigned to Nantahala's customers the percentage needed for their own energy requirements out of the total energy generated and purchased by the unified system.

The amount of energy generated by the unified system was not the same as the energy Nantahala received as entitlements.

Therefore the question is whether the Commission has changed the NFA and the 1971 Apportionment Agreement by using generation rather than entitlements under the agreements in calculating retail rates for Nantahala. We believe by requiring Nantahala's retail customers to pay demand and energy charges based on Nantahala's percent of the demand and energy requirements from the capacity of the entire system the Utilities Commission has used a methodology we cannot disturb. The methodology calculates the cost of the generation which the unified system trades to TVA for the electricity used by the system. In whatever form the entitlement comes to Nantahala-Tapoco, Nantahala's customers should only be charged for Nantahala's share of the costs of what was traded for the entitlements. We do not believe the methodology used by the Utilities Commission changes the NFA or the 1971 Apportionment Agreement.

Nantahala and Alcoa also argue that Tapoco's four hydroelectric plants have been licensed by the FERC for the express purpose of supplying power to Alcoa's Tennessee operations and that by directing a part of Tapoco's power to Nantahala's customers, the order of the Utilities Commission has imposed a condition on a federal license to operate their plants which it may not do. *See First Iowa Hydro-Electric Cooperative v. F.P.C.*, 328 U.S. 152, 66 S.Ct. 906, 90 L.Ed. 1143, *reh'g denied*, 328 U.S. 879, 66 S.Ct. 1336, 90 L.Ed. 1647 (1946). We do not believe the Commission's order diverts power from Tapoco to Nantahala. The order fixes the costs to Nantahala for the power it receives through the NFA and the 1971 Apportionment Agreement.

[2] Nantahala and Alcoa contend that the order of the Commission places an impermissible burden on interstate commerce in violation of Article I, § 8 of the United States Constitution. The Commission recited in its order that "Nantahala-Tapoco combined system's North Carolina public load has first call on the total electric energy output of the combined system, and to the extent that said output exceeds the requirements of the North Carolina public load, such excess will be available for sale and will be purchased by Alcoa." Nantahala and Tapoco argue that it is a violation of the Commerce Clause to prefer the residents of one state over the residents of another state; and after stating it would do this, the Utilities Commission did so by the methodology it used

in setting Nantahala's retail rates. They argue that this methodology reduced Nantahala's rates below its costs and shifted these costs to the combined system's Tennessee load.

If the Utilities Commission had used a methodology that gave "first call" to the North Carolina customers it would violate the Commerce Clause. In spite of its recital, we do not believe the Utilities Commission did this. We believe that the methodology used by the Commission allows Nantahala to recover the costs of the percentage of energy it used based on its percentage of the costs of the energy generated and purchased by the combined system. We do not believe this prefers North Carolina customers over Tennessee customers.

Nantahala and Tapoco say that an illustration of the shifting of costs to out-of-state customers may be found in the way the demand cost allocation factor for Nantahala is calculated. Based on Nantahala's peak load which was 24.6% of the total firm capability of the combined system, the Commission assigned 24.6% of the demand costs to Nantahala. Nantahala and Tapoco point out that Tapoco's peak load was only 44.9% of the total firm capability of the combined system. They say that Tapoco is thus required to shoulder 75.4% of the demand costs, 30% more than its responsibility. We believe that in determining Nantahala's reasonable demand cost, the Commission was not required to assure the recovery of 100% of the demand costs incurred in the combined system. Nantahala's customers should not be required to pay more for demand than that for which they are responsible, even if it means that all the combined system demand costs are not recovered. *See Utilities Comm. v. Telephone Co.*, 281 N.C. 318, 189 S.E. 2d 705 (1972), *superseded by statute, Utilities Comm. v. Power Co.*, 305 N.C. 1, 287 S.E. 2d 786 (1982).

Nor do we believe *New England Power Co. v. New Hampshire*, 455 U.S. 331, 102 S.Ct. 1096, 71 L.Ed. 2d 188 (1982) governs this case. It was said in that case that "Our cases consistently have held that the Commerce Clause of the Constitution, Art. I, § 8, cl. 3, precludes a state from mandating that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its borders or to the products derived therefrom." *Id.* at 338, 102 S.Ct. at 1100, 71 L.Ed. 2d at 197. The facts of that case are distinguishable from this case. In

that case the Supreme Court held that it was an impermissible burden on interstate commerce for the New Hampshire Public Utilities Commission to require a power company generating hydroelectric power in New Hampshire to sell an amount of power in New Hampshire at hydroelectric rates equal to the amount of hydroelectric power it generated in New Hampshire. In this case the Utilities Commission has set a rate for Nantahala-Tapoco based on the cost of producing the power.

Alcoa argues that it, Nantahala and Tapoco are regulated by TVA; that TVA has approved the NFA and the 1971 Apportionment Agreement, and the Utilities Commission cannot refuse to give effect to these agreements. As we have said, we do not believe the Utilities Commission has refused to give effect to these agreements. It has calculated the costs to Nantahala's customers of the power delivered to them under the agreements.

Alcoa also argues that the relationship between Alcoa, Nantahala and Tapoco is regulated by the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935 and the SEC has granted the companies an exemption from some of the requirements of the Act. We do not believe the order of the Utilities Commission has in any way affected the order of the SEC as to the three companies.

[3] Nantahala assigns error to the Commission's finding of fact that the NFA and the 1971 Apportionment Agreement resulted in substantial benefits to Alcoa to the detriment of Nantahala's customers. Nantahala argues first that the Commission made no finding of fact that the two agreements were unfair to Nantahala's customers but erroneously assumed our Supreme Court had found as a fact that they are unfair. It argues further that the only evidence at the hearing after the Supreme Court's remand is that the agreements were fair. The Supreme Court questioned the fairness of an agreement which required Nantahala to purchase additional power regardless of the adequacy of its own generation. Nantahala's witness testified that the only valid way to compare generation is on an hour-by-hour basis, that a hydroelectric power plant can generate more power than its customers use during a year, but if the power cannot be generated when there is a demand for it, the power generated during the period when it is not needed is useless. Nantahala's

witness testified this was the case for Nantahala during the test year and for that reason, Nantahala benefited from the firm power it received under the NFA and 1971 Apportionment Agreement. Nantahala also contends that the Commission did not address the evidence that during the 12-month period from June 1980 through May 1981, Nantahala's generation was less than its entitlement under the NFA and the 1971 Apportionment Agreement. Finally, Nantahala contends no consideration was given to the substantial benefits Nantahala's customers have received since 1941 because of the presence of Alcoa. Nantahala argues that the uncontradicted evidence shows that the NFA and 1971 Apportionment Agreement are fair to Nantahala's customers and the Commission should have so found.

We believe the Utilities Commission made an independent finding of fact that the NFA and the 1971 Apportionment Agreement were unfair to Nantahala's customers. We believe a reading of our Supreme Court's opinion in the previous appeal in this case leaves little doubt that they considered the NFA and the 1971 Apportionment Agreement unfair to the customers of Nantahala. We cannot hold because of this, however, that the Commission's finding of fact on this issue, which we believe was supported by the evidence, was not independently made. The Commission did not comment on all the evidence as to the fairness of the two agreements but it was not required to do so.

The Commission relied on evidence that in 1963 an agreement had been made under which Nantahala received a minimum of 360,000,000 kwh annually plus its actual production in excess of 360,000,000 kwh. This allocation was based on engineering studies which showed that under the most adverse water conditions Nantahala could generate 360,000,000 kwh annually with the average energy that could be generated annually to be 439,000,000 kwh per year. Under the 1971 Apportionment Agreement, Nantahala received only 360,000,000 kwh per year. The additional power which Nantahala had received under the 1963 agreement went to Tapoco and was passed on to Alcoa. There was evidence that the peaking capacity allotted Nantahala under the 1971 Apportionment Agreement is less than its actual capacity. This results in Nantahala having to pay a demand charge to TVA when Nantahala's customers demand is less than Nantahala's capacity. Nantahala's dams are upstream from Tapoco's dams. This means

Nantahala can store water during the winter months and, by releasing it in dry seasons, can provide water for Tapoco. This benefit to Tapoco was not taken into account in the 1971 Apportionment Agreement.

The Commission also relied on evidence that under the 1941 Fontana Agreement, Nantahala gave TVA the right in perpetuity to control the storage and flow of water from its hydroelectric projects. This constituted a loss of considerable value to Nantahala which the TVA recognized in the return entitlements of the NFA. Nantahala was paid $89,200 per annum by Alcoa for this loss under the 1963 agreement but received nothing for it under the 1971 Apportionment Agreement. There is evidence in the record which shows it is some benefit to TVA for Nantahala to be integrated into the TVA system. TVA recognized this in the NFA but no benefits were given to Nantahala in the 1971 Apportionment Agreement for this right.

There was evidence that the NFA is unfavorable to Nantahala in that it is structured to meet Alcoa's needs and not the needs of Nantahala. This is so because the return entitlement is structured to meet Alcoa's demand for a certain amount of stable electricity for purposes of aluminum production. It is not structured to meet Nantahala's need for peaking capacity which a utility with a public service load requires. Nantahala has a need for assured, but constantly variable amounts. It has this peaking capacity but it does not receive it under the NFA. We believe this evidence supports the Commission's finding of fact that the NFA and the 1971 Apportionment Agreement resulted in substantial benefits to Alcoa to the significant detriment of Nantahala's customers. There was substantial evidence that the two agreements were fair but this evidence was by no means uncontradicted. We cannot disturb this finding by the Utilities Commission.

[4] Nantahala contends that the Utilities Commission did not adopt a roll-in methodology within the scope of the remand by our Supreme Court. They argue that the Supreme Court envisioned a roll-in methodology which acknowledges the terms of the NFA and the 1971 Apportionment Agreement. Nantahala argues that the Supreme Court intended that the two agreements should be considered as valid and should control on the allocation of costs

and benefits on all matters to which they applied. Nantahala also argues that the methodology erroneously fails to draw any distinction between the value of firm power on the one hand and curtailable power on the other. Nantahala argues that curtailable power is of almost no value to a utility serving a public load because the public will not accept services that may require even short periods of darkness or lack of heat. Under the 1971 Apportionment Agreement, Nantahala received virtually all the firm power entitlements and Tapoco virtually all of the curtailable entitlements. Tapoco then had to pay TVA in order for TVA not to curtail power to Tapoco. Nantahala argues this should have been taken into account when adopting a roll-in methodology.

We do not agree that the Utilities Commission was required by the opinion of the Supreme Court to use a roll-in methodology that acknowledges the NFA and 1971 Apportionment Agreements as controlling as to costs and benefits. The Supreme Court did not prescribe a formula for a roll-in. In discussing the NFA and the 1971 Apportionment Agreement which the Court felt required Nantahala to purchase extra power for its customers although it generated sufficient power for them, the Court said that to suggest such an arrangement fairly served the customers of Nantahala "assaults the common sense of this Court." In light of this language by the Supreme Court, we do not feel its opinion requires the roll-in to be based on the NFA and 1971 Apportionment Agreement. It is true that the Supreme Court did not consider the federal questions in its opinion. We believe the Utilities Commission stayed within the mandate of the Supreme Court and it violated no federal law in so doing. The Utilities Commission was not required to consider payments made by Tapoco to prevent the curtailment of power because this did not occur in the test year.

Alcoa also contends that the roll-in applied by the Utilities Commission is not in conformity with the opinion of the Supreme Court. Alcoa points out that the Supreme Court's concern was with the fact that Nantahala did not receive the fair economic equivalent of what its generating plants were capable of producing as a result of which Nantahala was forced to purchase expensive TVA power. Alcoa argues that an analysis of the NFA and the 1971 Apportionment Agreement shows that Tapoco and Alcoa did not receive any hidden benefits from them. The unified

system did not receive as much in the entitlements as the system generated and Alcoa says this is because Nantahala's harvests of energy are neither as regular nor abundant as the Supreme Court was led to believe. This is because there is a substantial mismatch in the times at which the power is generated and the times it is needed. For this reason, TVA was not willing to give an entitlement of firm power equal to the generation of the unified system. Alcoa argues that the analysis which the Commission should have made and failed to do was whether the division of the entitlements between Nantahala and Tapoco was equitable. It says that any study of the division of these entitlements shows that Tapoco faired far worse than Nantahala in that it received less power in return for its contribution than did Nantahala. The Commission did analyze the 1971 Apportionment Agreement as well as the NFA as pointed out in another part of this opinion. It came to the conclusion that they were unfair to Nantahala's customers. We might reach a different conclusion but it is not for us to dictate to the Utilities Commission the weight to give material facts before it. We believe the weight the Commission gave to these facts was within the requirements of the Supreme Court's opinion.

[5] Alcoa also objects to the roll-in because it includes the power which Nantahala purchased from TVA but does not include the power which Alcoa purchased from TVA. We believe the Commission was correct in not considering the power purchased by Alcoa from TVA. The Commission's task was to determine the part Nantahala's retail customers should be required to pay for their share of the energy received by the unified Nantahala-Tapoco system under the NFA and purchased from TVA. They should not be required to pay for energy purchased by Alcoa outside the unified system.

Alcoa assigns error to the Commission's finding that Alcoa is a public utility and its requirement that Alcoa pay any portion of the refunds which Nantahala is financially unable to make. The Utilities Commission found Alcoa to be a public utility pursuant to G.S. 62-3(23)c which provides:

> The term "public utility" shall include all persons affiliated through stock ownership with a public utility doing business in this State as parent corporation or subsidiary corporation

> as defined in G.S. 55-2 to such an extent that the Commission shall find that such affiliation has an effect on the rates or service of such public utility.

Alcoa attacks this portion of the Utilities Commission's order on three grounds. It says (1) G.S. 62-3(23)c is unconstitutional for vagueness, (2) it constitutes an unlawful delegation of legislative authority, and (3) the Commission misinterpreted and misapplied this section of the statute.

[6] Under the due process clause of the Fourteenth Amendment to the United States Constitution, a statute is void for vagueness if its terms are so vague, indefinite and uncertain that a person cannot determine its meaning and therefore cannot determine how to order his behavior so as to avoid its dictates or avoid its application. *See Lanzetta v. New Jersey*, 306 U.S. 451, 59 S.Ct. 618, 83 L.Ed. 888 (1939) and *State v. Poe*, 40 N.C. App. 385, 252 S.E. 2d 843, *cert. denied*, 298 N.C. 303, 259 S.E. 2d 304 (1979), *appeal dismissed*, 445 U.S. 947, 100 S.Ct. 1593, 63 L.Ed. 2d 782 (1980). Alcoa argues that the legislature has failed to define what the effect on rates or services is necessary to impose public utility status on a parent corporation, and there is thus no guidance for the Commission as to whether Alcoa has had an effect on Nantahala. It argues further that a reading of the statute gives no indication of the parent company actions that the legislature was attempting to control or eliminate. We believe a person of ordinary understanding would know from reading the statute that if a parent corporation controls its wholly owned public utility in such a way that the rates of the utility are affected this has an effect on the rates and the parent corporation could be found to be a public utility. This prevents this section of the statute from being void for vagueness.

[7] Alcoa contends that G.S. 62-3(23)c violates Article I, § 6 of the North Carolina Constitution because it delegates legislative power to the Utilities Commission. It says this is so because it is a legislative decision as to what shall be a public utility and that by enacting this section of the statute, the legislature has allowed the Commission to determine what corporations shall be designated public utilities and how they shall be regulated without adequate legislative standards to guide the Commission. We believe, without discussing all the hypothetical situations that on

the facts of this case there has not been a delegation of legislative authority. In order to find that Alcoa is a public utility, the statute required the Utilities Commission to find that Alcoa was so affiliated with Nantahala as to have an effect on Nantahala's rates. The Commission so found and we believe this finding was supported by the evidence. We believe that the General Assembly has given the Utilities Commission sufficient guidelines so that if the facts are properly found by the Commission, it does not make policy but carries out legislative policy. By the same token when the Utilities Commission determined that Alcoa is a public utility we believe it was legislative policy and not the Commission's policy under which the Commission required Alcoa to be responsible for a part of the refund.

[8] Alcoa also contends the Utilities Commission has misinterpreted and misapplied G.S. 62-3(23)c. It argues that since the section contains the words "to such an extent," the Commission may only regulate to the extent of the precise impact Alcoa has had on the rates of Nantahala. It argues that the Utilities Commission did not attempt to determine the extent to which Alcoa's relationship with Nantahala has affected Nantahala's rates and services and thus did not comply with the mandate of G.S. 62-3(23)c. Assuming that Alcoa is correct in this argument the Commission found the following: "Alcoa has so dominated certain transactions and agreements affecting its wholly owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone the interest of its public utility customers in North Carolina." We believe this finding by the Commission is sufficient as to the extent Alcoa's affiliation with Nantahala had affected the rates of Nantahala so as to support the order of the Commission.

[9] Alcoa also contends the Commission has engaged in retroactive ratemaking which it does not have the power to do. *See Utilities Commission v. City of Durham*, 282 N.C. 308, 193 S.E. 2d 95 (1972). It says this is so because the rates established in this proceeding are for the period from July 1977 through August 1981 and Alcoa was not held to be a public utility until October 1980. Alcoa argues that to make it responsible for a refund prior to the time it was declared a public utility is retroactive ratemaking. Retroactive ratemaking occurs when a rate is set so as to permit collection in the future for expenses attributable to past

services. Alcoa was made responsible for a refund ordered for Nantahala for the period in question in this proceeding. We do not believe that it is retroactive ratemaking for Alcoa to be held responsible for a refund. The fact that it was not made a party to the proceeding until after the remand from the Supreme Court makes no difference.

[10] Tapoco assigns error to the Utilities Commission's finding that it is a public utility. The Commission found that Tapoco was a public utility under G.S. 62-3(23)a which provides a "person" is a public utility if it generates electricity for sale to the public. It also found Tapoco to be a public utility under G.S. 62-3(23)b which provides:

> The term "public utility" shall for rate-making purposes include any person producing, generating or furnishing any of the foregoing services to another person for distribution to or for the public for compensation.

The Commission advanced as a third reason for finding Tapoco to be a public utility that it had obtained from the Utilities Commission in 1955 a certificate of public convenience and necessity. The Commission found as a fourth reason for holding Tapoco is a public utility was that its articles of incorporation state that one of its purposes is to produce and provide electric power to the public and provide it with the powers of eminent domain.

We do not decide whether the Commission was correct in holding Tapoco to be a public utility as provided by G.S. 62-3(23)a because it holds a certificate of public convenience and necessity or because its articles of incorporation state that one of its purposes is to generate electricity for sale to the public. We do not believe that determination is necessary for a decision in this case. We believe the evidence is sufficient to find Tapoco is a utility for ratemaking purposes. Tapoco's generation is exchanged with TVA for power from TVA. We believe this constitutes furnishing electricity to TVA for distribution to the public for compensation. This would make Tapoco a public utility for ratemaking purposes. Although the Utilities Commission did not set a rate for Tapoco, the price Tapoco charges for electricity will be affected by the outcome of this case. We hold that for this case Tapoco is a utility for ratemaking purposes and is a proper party to the case.

Tapoco also contends that the decision of the FERC in *Town of Highlands v. Nantahala Power and Light Company*, 19 F.E.R.C. (CCH) ¶ 61 (14 May 1982), holding that Nantahala and Tapoco should not be treated as one utility for ratemaking purposes, is binding on this Court. The FERC, while holding that it would not roll-in the costs of the two companies, held that the 1971 Apportionment Agreement was unfair in that Nantahala does not receive under it the energy in proportion to its contribution under the NFA. We do not believe the action of the Utilities Commission in this case is inconsistent with the decision of the FERC. The FERC was passing on wholesale rates and did not attempt to set retail rates in North Carolina.

[11] Tapoco argues that the Commission's finding that Nantahala and Tapoco constitute a single integrated electric system operated as such by and as a coordinated part of the TVA system is arbitrary and capricious and not based on substantial evidence. It argues that the evidence shows that the two companies operate independently of each other, that they serve different customers and are regulated by different agencies. Finally, Tapoco argues that the historical development of the two companies is such that they cannot be considered one integrated system. These facts may have been sufficient for the Commission to have found that the two companies were not a single, integrated electric system but there were other facts. The two companies traded all their generation to TVA and received in exchange for this entitlements of energy which they divide as they please. We believe the Commission could conclude from these facts that the two companies constitute a single, integrated system for ratemaking purposes.

Tapoco also argues the Commission did not properly consider the evidence because it gave too much weight to what it called the findings of the Supreme Court. Tapoco points out that the Supreme Court cannot make findings of fact and for the Utilities Commission to refer to findings by the Court, which "findings" were made before Tapoco was a party to the proceedings is error. Tapoco argues that no weight should be given to this language of the Supreme Court. Although the Utilities Commission referred to some of the statements in the Supreme Court's opinion as findings we believe the Commission made its own findings based on competent evidence which we cannot disturb.

Finally, Tapoco argues that it was denied due process of law in the manner in which the hearing was conducted. It contends that it was entitled to notice as to the effect of holding it to be a public utility. It says that to hold it to be a public utility without defining what its duties would be in the future, thus leaving it with a Damoclean sword over its head, deprives it of due process. We have affirmed the holding of the Utilities Commission to the extent that Tapoco is held to be a public utility for purposes of this case and bound by any order entered in this case. We do not believe this leaves a Damoclean sword over the head of Tapoco.

[12] Alcoa argues that it was denied due process for several reasons. It says first that it was not given adequate notice of what it would be required to defend. It contends it was not put on notice that it might be required to be responsible for a part of the refund until the issuance of the Commission's order on 2 September 1981. Alcoa argues that the failure to be notified of what the issues would be deprived it of due process of law. *See Morgan v. United States*, 304 U.S. 1, 58 S.Ct. 773, 82 L.Ed. 1129 (1938). In this case Alcoa was made a party to the proceedings and held to be a public utility by order of the Commission on 3 October 1980. We believe that when Alcoa was held to be a public utility and made a party to a general rate case this was adequate notice that it might be held liable for the refund.

[13] Alcoa also contends its due process rights were violated by requiring it to prefile its testimony prior to the prefiling of the intervenors' testimony and requiring it to file its brief concurrently with the intervenors. It argues that it had a right to know what the contentions of the intervenors would be with a chance to meet them which it did not have under the procedure used by the Utilities Commission. Alcoa argues that it did not know the position of the intervenors as to the hidden benefits to Alcoa under the NFA and the 1971 Apportionment Agreement until the intervenors' brief was filed with the Utilities Commission at which time it did not have a chance to meet these contentions. We believe that in a general rate case to which Alcoa was a party and in which the NFA and the 1971 Apportionment Agreement were integral parts of the case Alcoa should have been forewarned that the intervenors intended to show the agreements were beneficial to Alcoa at the expense of Nantahala's customers. We hold the

procedure by which the Commission required Alcoa to prefile its testimony and its brief did not violate its due process rights.

Alcoa next contends it was deprived of due process by the Commission's consideration of evidence introduced at the hearings before it was made a party. There was sufficient evidence introduced at the hearings to which Alcoa was a party to support the Commission's findings of fact. We assume the Commission relied on this evidence.

[14] Alcoa next contends that the Utilities Commission improperly shifted the burden of proof. In its order the Utilities Commission made the following statement:

> These findings by the Supreme Court, that Nantahala and Tapoco constitute a single, integrated electric system and should be treated as one system for rate-making purpose [sic], have been carefully considered by the Commission for purposes of this proceeding. However, since Alcoa and Tapoco were not parties to the original proceeding that led to the June 14, 1977 Order, the Commission has allowed them and Nantahala to introduce evidence in the remand proceeding to challenge the findings of the Supreme Court.

Alcoa argues that by treating statements in the Supreme Court's opinion as findings of fact and requiring it to challenge them, the Commission placed a burden of proof on Alcoa which constitutes error. We do not believe we can hold the Utilities Commission placed the burden of proof on Alcoa. It did not say that it did so and there is sufficient evidence for the Commission to find the facts as it did without the use of any presumption against Alcoa. It is unfortunate that the Utilities Commission used the language it did since the Supreme Court did not and could not find facts. Nevertheless, we do not believe this language requires us to reverse the Utilities Commission.

[15] Alcoa's last argument is that the Commission violated its own rules by conducting the hearing as a general rate case and not as a complaint proceeding against Alcoa without the procedural rules of a complaint proceeding which could have given a different result. We believe the Utilities Commission was correct in conducting the proceeding as a general rate case. The primary question was what is a fair rate of return on Nantahala's invest-

ment so as to enable it by sound management to pay a fair profit to its stockholders and to maintain and expand its facilities and services in accordance with the reasonable requirement of its creditors. This would make it a general rate case. *See Utilities Comm. v. Gas Co.*, 259 N.C. 558, 131 S.E. 2d 303 (1963). The responsibility of Alcoa for Nantahala's refund was ancillary to the case.

[16] Nantahala assigns error to the Commission's requirement that it "refund to its North Carolina retail customers all revenue collected under the rates approved by Commission order issued June 14, 1977, to the extent that said rates produce revenue in excess of the rates approved herein." It argues that neither G.S. 62-132 nor G.S. 62-135 authorizes the Utilities Commission to order this refund. The opinion of our Supreme Court contains the following language:

> "We believe that essential fairness to all the parties is best served by allowing the increased rates to remain in effect, conditional upon Nantahala's guarantee that it will in the future refund to its customers any overcharges should the new rates ultimately be deemed excessive. Accordingly, we . . . direct the Commission to obtain adequate assurances of Nantahala's willingness and continued ability to refund such overcharges as may ultimately result from imposition of the 1977 rate schedule." *Utilities Comm. v. Edmisten, Attorney General*, at 444, 263 S.E. 2d at 592.

We believe the Utilities Commission was following the mandate of the Supreme Court in this portion of the order. We would have to overrule the Supreme Court to sustain this assignment of error, which we cannot do.

[17] Finally, Nantahala argues that the order of the Commission confiscates the property of Nantahala and thus violates its due process rights. It contends that its refund obligation is more than its net worth and although Alcoa was ordered to pay so much of the refund obligation as Nantahala cannot pay and remain solvent. Alcoa denies its obligation to pay. Nantahala says it may be years before Alcoa has exhausted its remedies in federal court and in the meantime Nantahala will not be able to serve its customers if it is responsible for the refund. It argues that such an order cannot be in the best interests of its customers.

We have affirmed the order as being within the mandate of our Supreme Court's opinion. We do not believe Nantahala's due process rights have been violated. The Utilities Commission has ordered that Alcoa be responsible for a part of the refund. We do not believe we should hold that Alcoa will not pay it and Nantahala will have to pay the entire refund, leaving it bankrupt.

We believe the Utilities Commission has conducted hearings and entered an order within the mandate of the Supreme Court's opinion. The appellants make persuasive arguments, particularly as to the equities involved. Indeed a good argument could be made that the best friend Nantahala's customers have is Alcoa. It financed the building of large hydroelectric facilities at a time when Nantahala could not have justified constructing them for its public customers. Nantahala's customers have had for many years the benefit of these facilities built at 1941 costs. Nevertheless, these are not factors which the law allows to be taken into account in setting utility rates.

Affirmed.

Judges ARNOLD and BRASWELL concur.

APPENDIX C

Opinion Of The North Carolina Utilities Commission, dated September 2, 1981

State of North Carolina
Utilities Commission
Raleigh

DOCKET NO. E-13, SUB 29 [Remanded]

BEFORE THE
NORTH CAROLINA UTILITIES COMMISSION

In the Matter of

Application of Nantahala Power and Light Company for Authority to Adjust and Increase Its Electric Rates and Charges	ORDER REDUCING RATES AND REQUIRING REFUND

BY THE PANEL: This proceeding is before the Commission upon remand from the Supreme Court of North Carolina. *Utilities Commission* v. *Edmisten, Attorney General,* 299 N.C. 432 (1980).

In an Order of the Commission issued March 11, 1981, this proceeding was assigned to be heard by the panel.

This matter was originally commenced by the application of Nantahala Power and Light Company (hereinafter Nantahala, Applicant, or Company), filed November 3, 1976, for an increase in retail rates and for a revised Purchased Power Adjustment Clause. The Commission, on June 14, 1977, issued its Order approving the requested retail rate increase based upon a cost of service study using the 1975 test year data and approving the Purchased Power Adjustment Clause (hereinafter PPA). From the entry of that Order the Intervenors appealed to the North Carolina Court of Appeals, which vacated the Commission Order and remanded the matter to the Commission for further proceedings, including a direction by that Court that the Commission consider a "roll-in" of Tapoco, Inc., and Nantahala for the purpose of establishing Nantahala's retail rates. 40 N.C. App. 109 (1979). Nantahala appealed to the North Carolina Supreme Court.

On March 5, 1980, the Supreme Court handed down its decision in *Utilities Commission* v. *Edmisten, Attorney General,* 299 N.C. 432. In its opinion the Supreme Court affirmed the decision of the Court of Appeals, insofar as it directed this Commission to consider whether a rate schedule computed as if Nantahala Power and Light Company and Tapoco, Inc., were one utility (a "roll-in") would be in the best interests of the customers of Nantahala. The Court held as follows:

> "The Commission erred in giving only minimal consideration to the evidence suggesting the propriety of the roll-in device. The case is remanded with directions to the Commission to obtain and consider information and data showing what Nantahala's cost of service to its customers would be if this method of rate making were used and whether Nantahala's customers would benefit thereby." 299 N.C., at 443.

The Supreme Court left to the discretion of the Commission the choice of procedure to obtain the necessary information for this computation. The Supreme Court reversed that part of the Court of Appeals' decision which vacated the rate increase, holding at page 444:

> "The Commission's order of 14 June 1977 authorizing an increase in Nantahala's rates was vacated by the Court of Appeals. The effect of the Court of Appeals' decision was stayed, however, by this court's issuance of a writ of supersedeas pending the outcome of this appeal. Although that writ is hereby dissolved, we believe that essential fairness to all the parties is best served by allowing the increased rates to remain in effect, conditioned upon Nantahala's guarantee that it will in the future refund to its customers any overcharges should the new rates ultimately be determined excessive. Accordingly, we reverse the Court of Appeals' setting aside of the order of 14 June 1977 and direct the Commission to obtain adequate assurances of Nantahala's

willingness and continued ability to refund such overcharges as may ultimately result from imposition of the 1977 rate schedule."

The Supreme Court remanded the cause to the "Court of Appeals for remand to the Utilities Commission for further proceedings consistent with this opinion."

Upon remand to the Commission, the following events took place:

On May 9, 1980, the Intervenors in this docket (the Attorney General, Henry J. Truett, Town of Bryson City, and Swain County) filed with the Commission a Motion for Rehearing Before the full Commission. On May 19, 1980, Nantahala filed its Response to Motion for Rehearing before the full Commission.

On May 14, 1980, the Intervenors filed the following pleadings: Motion for Prehearing Conference; Motion for Hearing Respecting Applicant's Ability to Refund Possible Overcharges; Motion to Join Alcoa and Tapoco, Inc., as Parties.

In response to these Motions, Nantahala filed the following pleadings on June 4, 1980: Response to Motion for Prehearing Conference; Response to the Motion for Hearing Respecting Applicant's Ability to Refund Possible Overcharges; and Response to the Motion to Join Alcoa and Tapoco, Inc., as Parties.

On June 4, 1980, Aluminum Company of America (Alcoa) and Tapoco, Inc. (Tapoco), each filed a separate Response to Motion to Join Alcoa and Tapoco, Inc., as Parties. (On June 27, 1980, the Intervenors filed Intervenors' Reply to Applicant's Response to Motion for Rehearing Before the Full Commission and Intervenors' Reply to Applicant's Response to Motion for Refund of Possible Overcharges.)

On June 24, 1980, the Commission ordered that these motions and responses should be set for oral argument before the full

Commission on July 11, 1980. The matter came on for argument as scheduled. with Nantahala, Tapoco, Alcoa, and the Intervenors being present and represented by counsel.

On July 29, 1980, the Commission issued an Order Setting Hearing and Requiring Data and Testimony. This Order scheduled a hearing for August 28 (later rescheduled to August 29) to allow Tapoco and Alcoa to appear and contest the Commission's jurisdiction to join them as parties to this proceeding. This Order also provided that the increased rates approved in the Order of June 14, 1977, would remain in effect upon the filing of an Undertaking by Nantahala; that a hearing be scheduled beginning December 9, 1980, to consider information and data showing what Nantahala's cost of service to its customers would be if Nantahala and Tapoco were treated as a single system for rate-making purposes and to consider whether Nantahala's customers would benefit thereby; that Nantahala and Alcoa prefile certain information; and that Nantahala give Notice to the Public of the hearing.

The hearing de novo to determine whether Alcoa and Tapoco should be joined as parties to this proceeding was held on August 29, 1980.

On September 24, 1980, Motion was filed by Nantahala for an extension of time to answer data request and to prefile testimony and exhibits; an Order Granting Extensions of Time and Continuing Hearing of December 9, 1980, was issued on September 26, 1980.

On September 22, 1980, an Undertaking to Refund was filed by Nantahala.

Based upon the testimony and exhibits presented at the de novo hearing on August 29, 1980, the Commission issued an Order on October 3, 1980, declaring Alcoa to be a public utility in North

Carolina pursuant to G.S. 62-3(23)c. and subject to the jurisdiction of this Commission, and further declaring Tapoco to be a public utility in North Carolina and subject to the jurisdiction of this Commission, and ordering that each be made a party respondent in this proceeding.

On October 13, 1980, the Commission issued an Order Requiring Parties Alcoa and Tapoco to Comply with Data and Testimony Filings Rescheduling Hearing to March 31, 1981, and Requiring Public Notice.

On October 27, 1980, Joint Statement of Exceptions to the Commission Order of October 3, 1980, and Motion for Clarification was filed with the Commission by Alcoa and Tapoco. Response of Public Staff and Response of Intervenors to Alcoa and Tapoco's Motion for Clarification were filed on November 14, 1980.

On December 22, 1980, the Commission issued an Order Clarifying Procedures and Affirming Filing Schedules.

On January 16, 1980, Petition to Intervene was filed by Cherokee, Graham, and Jackson Counties, North Carolina; the Towns of Andrews, Dillsboro, Robbinsville, and Sylva, North Carolina; and the Tribal Council of the Eastern Band of Cherokee Indians. Nantahala filed response to this Petition on February 3, 1981.

On January 16, 1981, Motion to Expunge Data from the record was filed by all of the Intervenors in this matter, to which Responses by Nantahala and Tapoco and Alcoa were filed with the Commission on February 6, 1981. The data sought to be expunged related to the appreciation in value of the properties of all projects of Tapoco under license from the Federal Energy Regulatory Commission or its predecessor.

On February 5, 1981, all the Intervenors filed a Motion to Extend Filing of Prefiled Testimony and Exhibits to March 9, 1981, which was allowed by Commission Order of February 17, 1981.

On February 26, 1981, the Commission issued an Order Allowing Intervention of Cherokee, Graham, and Jackson Counties; the Towns of Andrews, Dillsboro, Robbinsville, and Sylva; and the Tribal Council of the Eastern Band of Cherokee Indians.

On March 11, 1981, the Commission issued an Order assigning the hearing to the panel, rather than the Commission, because of the heavy demands of the Commission's Calendar.

Motion to Intervene was filed with the Commission on March 13, 1981, by Muriel Maney, Route 1, Whittier, North Carolina, and allowed by appropriate Order.

On March 16, 1981, all of the Intervenors in this case filed Response to Respondents' Motion for Postponement of Date for Commencement of Hearings for Presentation and Cross-Examination of Witnesses.

Alcoa and Tapoco filed on March 18, 1981, their first set of data requests to the Public Staff and Intervenors.

On March 18, 1981, the Commission issued an Order Denying the Motion to Expunge Data.

On March 20, 1981, Motion to Reject for Filing Portions of Intervenors' Prefiled Testimony was filed by Respondents Alcoa and Tapoco.

On March 23, 1981, Respondents Alcoa and Tapoco filed answer to Intervenors' Motion to Strike the Testimony and Exhibits of Witnesses Little and Toof.

On March 23, 1981, there was filed with the Commission the Response of Alcoa and Tapoco to Intervenors' Motion to Require Alcoa and Tapoco to Join in the Execution of Nantahala's Undertaking to Refund or to Guarantee Nantahala's Continuing Financial Viability.

On March 24, 1981, the Commission issued an Order Denying the Motion of Alcoa and Tapoco for Postponement of Date for Commencement of Hearings and scheduled further hearings, if necessary, for May 18 through 20, 1981.

On March 27, 1981, Respondents' Second Set of Data Requests to the Public Staff and the Intervenors was filed with the Commission.

The proceeding came on for hearing as scheduled on March 31, 1981. Three public witnesses testified in support of the Intervenors: Marie Leatherwood; Veronica Nicholas, a County Commissioner of Jackson County; and Walter David McCoy, Chairman of the Tribal Council of the Eastern Band of Cherokee Indians. The Commission then heard oral argument on the motion previously filed by the Intervenors to Require Alcoa and Tapoco to Join in the Execution of Nantahala's Undertaking to Refund or to Guarantee Nantahala's Continuing Financial Viability. Upon conclusion of the arguments, the Commission deferred ruling on the Motion until a later date. On the afternoon of March 31 and continuing through April 1-3, April 7-9, and May 18-21, the Commission held hearings, the witnesses and the subject of their testimony being summarized as follows:

For Nantahala and the Respondents Alcoa and Tapoco: (1) John D. Russell of John D. Russell Associates, Inc., a public utility consulting firm, testified as to procedures he had used and the results obtained in preparing depreciation rates and depreciation accrual reserves for Tapoco; he also testified on the fair value of the Tapoco properties; (2) Robert D. Buchanan, the Assistant Controller—Financial Accounting of Alcoa, testified as to the 1975 year-end balance sheets of Nantahala and Tapoco, methods of making allowances for depreciation, Tapoco's capital structure, the combined operating income and expenses for Nantahala and Tapoco for the year ended December 31, 1975, rate of return for the two entities, and certain adjustments related to the forego-

ing data; (3) Herbert J. Vander Veen, a Principal in the Washington Utility Group of Ernst & Whinney, testified as to his proposed method for a rolled-in cost of service for Nantahala-Tapoco and as to his reasons why he did not think any type of roll-in was appropriate; (4) B.D. Cockrell, Alcoa's Operating Manager—Power, testified on the development of the Alcoa Tennessee operations, and of Tapoco and Nantahala and on why in his opinion the roll-in was not warranted; (5) David I. Toof, a supervisor in the Washington Utility Group of Ernst & Whinney, testified as to the Supreme Court's concern that Nantahala's relationship with Alcoa has had an adverse impact on Nantahala's ratepayers; as to certain of the analytical techniques used by Respondents' witness Little in an analysis of the impact that Alcoa has had on the rates paid by Nantahala's customers during the period 1940-1978; and as to how a "revenue requirement model was defined and developed, together with specific sets of assumptions which were used to produce alternative scenarios involving Nantahala's operations; (6) John M. Little, a manager in the Washington group of Ernst & Whinney, also testified as to the Supreme Court's concern that Nantahala's relationship with Alcoa has had an adverse impact on Nantahala's ratepayers; he also explained the results of studies conducted by him and Mr. Toof in which they analyzed the impact that Alcoa has had on Nantahala and its ratepayers, 1940-1978; (7) William M. Jontz, President and Chief Executive Officer of Nantahala, testified as to whether a rolled-in cost of service for Nantahala and Tapoco is appropriate for setting retail rates, and as to the history of the development of Nantahala; (8) George Popovich, Alcoa's power management consultant, testified on some of the factual circumstances surrounding the negotiations of the New Fontana Agreement during the period 1960-1962, and on the questions raised by the Supreme Court in its order remanding the instant case for further hearings; and (9) William J. Leininger, codirector of Ernst & Whinney's Washington, D.C., Group, testified as to "certain concerns" of the Supreme Court in remanding the instant case.

Prior to completion of Mr. Popovich's cross-examination, Assistant Attorney General Richard L. Griffin testified on his own behalf and on behalf of the Intervenor Attorney General as to certain communications between himself and a securities analyst concerning a securities arı ngement that Nantahala had with First Union National Bank.

For the Intervenors: (1) Da l A. Springs, head of the power supply planning and power syst planning section of Southern Engineering Company of Georgia testified as to his review and analysis of materials filed in this proceeding, including various contracts between or among Nantahala, Tapoco, Alcoa, and TVA; as to recommended appropriate capacity and energy allocation factors under a rolled-in allocation of cost responsibility of the Nantahala-Tapoco system; as to recommended separation of utility costs and revenues from nonutility costs and revenues. He also presented rebuttal to some of the testimony of the Nantahala, Alcoa, and Tapoco witnesses. (2) J. Bertram Solomon, electric rate consultant with Southern Engineering Company of Georgia, testified as to the revenues, expenses, and investments of Nantahala and Tapoco for the test year, as to whether a roll-in method of setting retail rates would benefit the retail customers, and as to an appropriate capital structure and rate of return for the Nantahala-Tapoco system.

In rebuttal to Intervenors' testimony, Nantahala and/or Alcoa and Tapoco sponsored testimony by the following witnesses: (1) N. Edward Tucker, Nantahala's Vice President for rates and regulation; (2) C.E. Pfeiffer, Alcoa's treasurer; (3) George Popovich; and (4) Herbert J. Vander Veen.

In addition to the testimony of the foregoing witnesses, virtually every one of them also sponsored one or more supporting exhibits.

Following the close of the hearings, the parties were requested to file briefs and proposed Findings of Fact and Conclusions of

Law on July 27, 1981 (later extended to August 5, 1981). The parties filed briefs and proposed orders in apt time.

Upon consideration of the testimony and exhibits presented at the hearing and the entire record in this docket, the Commission makes the following

FINDINGS OF FACT

1. Nantahala is a duly organized public utility company under the laws of North Carolina, subject to the jurisdiction of this Commission, and is holding a franchise to furnish electric power in the western part of the State of North Carolina under rates and service regulated by this Commission as provided in Chapter 62 of the General Statutes.

2. Tapoco is a duly organized public utility and is domesticated as such under the laws of North Carolina. It is subject to the jurisdiction of this Commission with respect to its retail rates and electric service as provided in Chapter 62 of the General Statutes.

3. Both Nantahala and Tapoco are wholly owned subsidiaries of Alcoa. Alcoa is a public utility pursuant to G.S. 62-3(23)c. and is subject to the jurisdiction of this Commission with respect to retail ratemaking.

4. The Nantahala and Tapoco electric facilities constitute a single, integrated electric system and are operated as such by, and as a coordinated part of, the Tennessee Valley Authority (TVA) system.

5. For purposes of setting the pplicant's rates in this proceeding the Nantahala and Tapoco systems should be treated as one entity with respect to all matters affecting the determination of the Applicant's reasonable cost of service applicable to its North Carolina retail operations.

6. The New Fontana Agreement (NFA), executed by TVA, Alcoa, Nantahala, and Tapoco, and the resultant 1971 Apportionment Agreement between Tapoco and Nantahala, have resulted in substantial benefits to Alcoa to the significant detriment of the customers of Nantahala.

7. The methodology employed by the Intervenors in making jurisdictional cost allocations and cost-of-service allocations is the most appropriate for use in this proceeding. Consequently, each finding of fact appearing in this Order which deals with the proper level of rate base, revenues, and expenses has been determined based upon said methodology.

8. The reasonable original cost of the Nantahala-Tapoco property used and useful in providing electric service to its retail customers in North Carolina is $36,951,000. The reasonable accumulated provision for depreciation is $18,202,000, and the reasonable original cost less depreciation is $18,749,000.

9. The reasonable replacement cost of Nantahala's property used and useful in providing retail electric service in North Carolina is $57,795,000.

10. The fair value of Nantahala-Tapoco's utility plant used and useful in providing electric service to its retail customers in North Carolina should be derived from giving 40% weighting to the original cost less depreciation of Nantahala-Tapoco's utility plant in service and 60% weighting to the trended original cost less depreciation of Nantahala-Tapoco's utility plant. By this method, using the depreciated original cost of $18,749,000 and the reasonable replacement cost of $57,795,000, this Commission finds that the fair value of said utility plant devoted to intrastate retail electric service in North Carolina is $42,177,000. This fair value includes a reasonable fair value increment of $23,428,000.

11. The reasonable allowance for working capital is $1,113,000.

12. The fair value of Nantahala-Tapoco's plant in service used and useful in providing electric service to its retail customers within the State of North Carolina of $42,177,000 plus the reasonable allowance for working capital of $1,113,000 less customer deposits of $188,000 yields a reasonable fair value of Nantahala-Tapoco's property in service to North Carolina retail customers of $43,102,000.

13. The approximate gross revenues for the test year, after accounting and pro forma adjustments, under rates approved by Commission Order of June 14, 1977, are $11,067,000.

14. The approximate level of test year operating expenses under rates approved by Commission Order of June 14, 1977, after accounting and pro forma adjustments, including taxes and interest on customer deposits, is $8,322,000 which includes an amount of $1,133,000 for actual investment currently consumed through reasonable actual depreciation after annualization to year-end levels.

15. The reasonable original cost capital structure for use herein is as follows:

Item	Percent
Debt	40.05
Common equity	37.00
Cost-free	22.95
Total	100.00

and when the fair value increment is added, the reasonable fair value capital structure becomes:

Item	Percent
Debt	18.28
Common equity	71.24
Cost-free	10.48
Total	100.00

16. The fair rate of return that Nantahala should have the opportunity to earn on the fair value of its investment devoted to its North Carolina retail operations is 4.20%.

17. The approximate annual level of revenues which Nantahala should be authorized to collect through rates charged for its sales of service, based upon the findings of fact set forth hereinabove, is $9,032,000.

18. The rates and charges of Nantahala, based upon the adjusted test year level of operations, under rates approved by Commission Order of June 14, 1977, are excessive to the extent that said rates produce a level of revenue which is $2,035,000 ($11,067,000—$9,032,000) greater than the Applicant's revenue requirement (cost of service). Thus, Nantahala should be required to reduce said rates and charges in a manner so as to achieve an annual gross revenue reduction of approximately $2,035,000, based upon the adjusted test year level of operations.

19. Nantahala should be required to refund to its North Carolina retail customers all revenue collected under the rates approved by Commission Order issued June 14, 1977, to the extent that said rates produced revenue in excess of the rates approved herein. Said refund shall include revenues collected under the Company's base rate structure as well as through operation of the purchased power adjustment formula plus interest computed and compounded at the legal annual rate.

20. The purchased power adjustment clause is a just and reasonable rate and a reasonable method by which Nantahala can recover a part of its reasonable operating expense.

21. Alcoa has so dominated certain transactions and agreements affecting its wholly owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers

in North Carolina. Therefore, this Commission is compelled to order that, to the extent Nantahala is financially unable to make the revenue refunds required in this Order, Alcoa shall refund all or any portion of the aforementioned revenue refunds that Nantahala is financially unable to make.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 1

The evidence for this finding is contained in the verified Application and in the record as a whole. This finding is essentially procedural and jurisdictional in nature and is not contested.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 2 AND 3

The Commission Order of October 3, 1980, in this docket declared Tapoco and Alcoa to be public utilities in North Carolina and subject to the jurisdiction of the Commission. That Order, with its findings and conclusions and discussion of the evidence in support thereof, is attached hereto as Exhibit A and is incorporated into this Order by reference. The Commission concludes that Tapoco is a public utility and is subject to the jurisdiction of this Commission with respect to its retail rates and electric service. The Commission also concludes that Alcoa is a public utility pursuant to G.S. 62-3(23)c. and is subject to the jurisdiction of this Commission with respect to retail ratemaking.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 4 AND 5

In its opinion, *Utilities Commission* v. *Edmisten, Attorney General,* 299 NC 432, the Supreme Court stated, at page 435.

> "The transmission facilities of Nantahala and Tapoco are integrated and interconnected into a single system. . ."

And at pages 442 and 443, the Supreme Court further concluded that the Nantahala-Tapoco electrical system is a single system:

> "In light of the foregoing, we cannot agree with the Commission that the evidence is insufficient to warrant the treatment of Nantahala and Tapoco as a single system for rate making purposes. The 'roll-in' device, or technique, for rate making computation seems especially appropriate in a case such as this where one physically integrated system interconnected in such a way that all power available to the system can be used to enhance its overall reliability and supply its requirements as a whole, is presided over by two corporate entities (See, e.g., *Central Kansas Power Co.* v. *State Corporation Commission,* 221 Kan. 505, 561 P. 2d 779 (1977)). This is especially true when both corporate entities are wholly owned by a parent corporation which benefits from the power generated by the system. This device does nothing more than recognize that the two corporate entities ought, for rate making accounting purposes, be treated as the one electrical power producing and distribution system which, in fact, they are. If the then unlawful preferences are indeed accorded to Alcoa to the detriment of Nantahala's customers because of the separate corporate structures and the intercorporate apportionment agreements, this rate making device would seem to eliminate them. . . ."

These findings by the Supreme Court, that Nantahala and Tapoco constitute a single, integrated electric system and should be treated as one system for ratemaking purpose, have been carefully considered by the Commission for purposes of this proceeding. However, since Alcoa and Tapoco were not parties to the original proceeding that led to the June 14, 1977, Order, the Commission has allowed them and Nantahala to introduce evidence in the remand proceeding to challenge the findings of the Supreme Court. Notwithstanding the assertions of Mr. Vander Veen and other witnesses for the respondents that the Court's decision was based on the "misconception" that Nantahala and Tapoco are a single, unified system, the evidence presented in the

remand proceeding strongly reinforces the Supreme Court's determination in this regard. The evidence is overwhelming and undisputed that Nantahala and Tapoco are both wholly owned by one corporate parent, Alcoa. The facilities of Nantahala and Tapoco are located in contiguous areas in western North Carolina. The Nantahala and Tapoco electric facilities are physically interconnected with each other, and both companies are interconnected with TVA; power can be dispatched and transmitted from the facilities of one to the facilities of the other. The original Fontana and the New Fontana Agreements treat the facilities of Nantahala and Tapoco without discrimination and make them an integrated part of, and subject them to coordination by, the TVA system. By the terms of these agreements TVA receives the output of all of the hydro resources of both Nantahala and Tapoco, except for three small projects of Nantahala. By terms of these agreements Tapoco and Nantahala also turn over to TVA control of production and stream flow. Accordingly, TVA determines for Tapoco and Nantahala, as a single entity, both electric generation and stream flow and operates them as a coordinated system as a part of TVA's own system. In turn, Tapoco and Nantahala jointly receive back from TVA certain entitlements of power which they divide between themselves by the 1971 Nantahala-Tapoco Apportionment Agreement.

Intervenors' witness Springs testified that it is a "false and arbitrary assumption that NP&L and Tapoco operate as isolated systems when in fact they do not." When witness Springs was asked whether the Nantahala and Tapoco facilities should each be operated as a separate and independent system, he replied: "No, by coordinating them as one system with TVA, the outputs of the generating resources are maximized." (Tr. Vol. 15, p. 50) Witness Springs also testified that, from an engineering standpoint, the Nantahala and Tapoco facilities should be operated as one utility.

The Commission concludes that the Nantahala and Tapoco electric facilities constitute a single, integrated electric system and are operated as such by, and as a coordinated part of, the TVA system.

The Commission also concludes that, for purposes of setting Nantahala's rates in this proceeding, the Nantahala and Tapoco systems should be treated as one entity with respect to all matters affecting the determination of Nantahala's reasonable cost of service applicable to its North Carolina retail operations. Elsewhere in this Order the Commission has made findings and conclusions determining that a roll-in of Tapoco together with Nantahala for rate-making purposes will result in a significant reduction in the cost of providing public utility electric service to the customers of the combined Nantahala-Tapoco system. The Commission incorporates those findings and conclusions herein.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 6 AND 7

The Commission, as previously discussed, has determined for purposes of this proceeding that the Nantahala and Tapoco systems should be treated as one entity. The Commission must now determine the proper allocation methodology to be used in apportioning the combined revenues, expenses, and investment of the Nantahala-Tapoco system between that applicable to said system's North Carolina retail operations and that applicable to said system's operations over which this Commission has no jurisdiction.

Generally speaking, the allocation methodology that the companies (Alcoa, Tapoco) would have the Commission adopt for use herein is based in all material respects upon demand and energy entitlements as described and set forth in the New Fontana Agreement and the Tapoco-Nantahala Apportionment Agreement; whereas, the allocation methodology that the Intervenors

would have the Commission adopt is based in all material respects upon the assumption that the electric energy requirements of the Nantahala-Tapoco combined system's North Carolina public load has first call on the total electric energy output of the combined system, and to the extent that said output exceeds the requirements of the North Carolina public load, such excess will be available for sale and will be purchased by Alcoa. The Commission will first address the propriety or, perhaps more appropriately, the impropriety of basing cost allocations on demand and energy entitlements as contained in the New Fontana Agreement and the Tapoco-Nantahala Apportionment Agreement.

There are a number of inequities to Nantahala that arise out of both the New Fontana Agreement (hereafter NFA) and the 1971 Tapoco-Nantahala Apportionment Agreement (hereafter Apportionment Agreement) that result in Alcoa's receiving concealed benefits. Because the inequities of the NFA are more subtle and difficult to express than are those of the Apportionment Agreement, we discuss the 1971 Apportionment Agreement first.

A. *Concealed Benefits of the Apportionment Agreement*

(1) Quantity of Nantahala's Production

Alcoa's power consultant George Popovich devised the Apportionment Agreement share for Nantahala at 360 million Kwh annually. Nine years earlier, Mr. Popovich had determined that a considerably higher apportionment share would be required for Nantahala. On May 14, 1962, in a memo to an Alcoa executive, Mr. Popovich wrote:

> "A. The Alcoa-NP&L Co. Contract of October 1954 as verbally revised should guarantee that the annual energy entitlements of NP&L Co. are 360 million Kwh (41,000 Kw) primary and 79 million Kwh (9,000 Kw) interruptible. This is a benefit in that it gives NP&L Co. this assured supply even in the event of future conditions of stream flow which

might be more adverse than that experienced in the historical period of record. These energy entitlements have been independently determined by engineers employed by NP&L Co. Alcoa has checked and accepted their determinations. . . ." (underlining supplied) (Intervenors Popovich Rebuttal Cross-Examination Ex. 1, pp. 3-4)

The engineering study referred to by Mr. Popovich had been made by Ebasco in the year 1960 and a copy of that study is Item 4, A.G. Jontz Cross-Examination Exhibit 1 (original hearing). That study states:

> "(a) The primary energy capability under the most adverse water conditions of record. This quantity was found to be 360 million kilowatt hours per year.
>
> "(b) The average energy that could be generated annually by these hydroelectric plants. This quantity was found to be 439 million kilowatt hours per year."

We note that the 79,000,000 Kwh referred to by Mr. Popovich as interruptible is the difference between primary and average energy referred to in the Ebasco study. (When the three small Nantahala plants not included in the NFA return entitlement from TVA are deducted, the 79,000,000 Kwh is reduced to 66,000,000 Kwh.)

Based upon these established and known facts, after the NFA was executed, in 1963 Alcoa entered into a written agreement with Nantahala wherein Nantahala was apportioned a certain share of the NFA return entitlements. This agreement, identified as Item 35, Truett, et al., Judicial Notice Ex. 1 (original hearing), and also Applicant's Exhibit WMJ-R11, apportioned to Nantahala 360,000,000 Kwh minimum plus actual production in excess of 360,000,000 Kwh, that is, an average of 426,000,000

Kwh annually (360,000,000 Kwh + 66,000,000 Kwh), using this language:

> "2. Nantahala should be entitled each month to an amount of energy which when added to its generation at plants not operated under the above mentioned agreement of December 27, 1962, shall be the equivalent either to its total actual generation during that month or to the one-twelfth of its annual primary generating capability whichever shall be the greater. The annual primary generating capability of Nantahala as used in the foregoing sentence is agreed to be 360 million kilowatt hours."

By this agreement, Nantahala received annually the average of 426,000,000 Kwh, of which 360,000,000 Kwh was guaranteed as a minimum.

During the remanded hearings, Intervenors put on similar independent evidence from their expert witness Springs. Witness Springs testified, at Vol. 15, Tr. p. 33:

> ". . . NP&L's contributions, excluding the three small projects not turned over to TVA, are approximately . . . 426,000,000 Kwh of average energy (Ebasco Study) . . ."

Despite all of the above facts, when Mr. Popovich devised the 1971 Apportionment Agreement, Nantahala received *only* 360,000,000 Kwh annually. Nantahala was deprived of an average of 66,000,000 Kwh annually. The detriment to Nantahala constitutes a benefit to Tapoco that is passed on to Alcoa.

Witness Springs testified that "NP&L did not come out very well in this 'trade.' " (Vol. 15, Tr. p. 19)

(2) Quantity of Nantahala's Peaking Capacity

As one aspect of the 1971 Apportionment Agreement, Nantahala has a limitation placed upon its peaking capacity of 54,300 Kw with the result that any time it has to provide a customer

demand in excess of 54,300 Kw, it must pay a monthly demand charge to TVA for all power over that limitation. If the limitation were at a higher level, of 81,800 kilowatts, a monthly demand charge would be saved for 27,500 kilowatts, i.e., the difference between 81,000 Kw and 54,300 Kw, when customer demand equalled or exceeded the 81,000 kilowatt level.

Demand costs imposed on Nantahala for use of capacity between its assigned capacity of 54,300 kilowatts and its actual capacity, of 81,800 kilowatts, would represent an expense to Nantahala and, thus, a savings to its New Fontana Agreement sister, Tapoco, since the capacity constraints for the TVA return entitlements are jointly shared by them under the New Fontana Agreement. Tapoco's savings are passed on to Alcoa so as to become Alcoa savings, i.e., a concealed benefit.

The record clearly and convincingly establishes that Nantahala's correct capacity is 81,800 kilowatts and that, by being assigned a demand limitation of only 54,300 kilowatts, Nantahala suffers significant monthly financial loss.

The 1960 Ebasco Study (Item 4, A.G. Jontz Cross-Exam Ex. 1, Table A-1, (original hearing)), undertaken for Nantahala by independent experts, computed Nantahala's plant capacity, under the most adverse water conditions, at 85,400 kilowatts. After deducting the three small plants excluded from the NFA, that capacity is 84,300 kilowatts (Vol. 15, pp. 147–148). The Ebasco study computation is confirmed in an old memorandum of W.T. Walker (Intervenors' Ex. DAS-18, pp. 4–5 of 8), Nantahala's president, wherein he notes that in 1965 another independent source had analyzed Nantahala's *allowed capacity* under the original Fontana Agreement to be only 35,172 kilowatts. Not only was the allowed capacity under the original Fontana Agreement regarded as unrealistic, but a capacity much higher

than 54,300 Kw was thought to be proper. The Walker memorandum states:

> "... He thought this allocated capacity to be unreasonable for a company with 84.3 Mw of co-ordinated capacity under adverse water conditions, so he allocated 74.9 Mw to Nantahala ..."

The Walker memorandum continues, at page 5 of 8, by even noting that "George Popovich's proposed allocation to Nantahala ..." for capacity would be 76,000 Kw.

Based upon these established facts, after the NFA was executed, Alcoa entered a written agreement with Nantahala in the year 1963 wherein Nantahala was allowed to use capacity without limitation. This agreement, mentioned in the previous section, identified as Item 35, Truett, et al., Judicial Notice Ex. 1 (original hearing) and also Applicant's Ex. WMJ-R11, thereby permitted Nantahala to use actual capacity to the limits assigned by the 1960 Ebasco study.

Intervenors' witness Springs testified that after adjustment for reserves, the allowable capacity of 84,300 kilowatts, under most adverse water conditions, should be 81,800 kilowatts (Vol. 15, Tr. p. 37).

Despite these impressive studies and facts, when Mr. Popovich accomplished his study (Intervenors' Ex. DAS-12) for the 1971 Apportionment Agreement, while accepting the most adverse water capacity factor of 84,300 kilowatts, he deducted 27,500 kilowatts for the "largest unit out" to reach an assigned capacity of 54,300 Kw. This deduction is for the Nantahala facility which forms upwards of 50% of the entire Nantahala generation system of 11 dams.

If Nantahala were a separate and independent system, a deduction of the "largest unit out" might be appropriate to determine assured capacity. However, Nantahala is not and never has

been a separate electric system—it was not so designed. Nantahala's two largest facilities are Thorpe (previously Glenville), completed in 1941 with 21,600 Kw capacity, and Nantahala, completed in 1942 with 43,200 Kw capacity (See Intervenors' Ex. DAS-1, p. 8 of 14). The Thorpe and Nantahala facilities comprise about 65% of Nantahala's entire system. At the time of their construction, Alcoa obtained a certificate of necessity from the War Department and *expressly argued and avowed that they were part of the Alcoa system.* Intervenors' Ex. DAS-7, p. 5 of 11; also being Applicant's Ex. WMJ-R5. In that exhibit, at pp. 5-6 of 11, it is recorded that Alcoa said of these two Nantahala plants:

> "At the present time, Alcoa receives power from three dams located on tributary waters of the Tennessee River at Calderwood, Tennessee and Tapoco, North Carolina, (Cheoan and Santeetlah developments). . . .
>
> "To improve the present power situation and to supply a portion of the 200,000 additional Kw required for national defense purposes, *applicant proposes to build two new developments,* also on tributaries of the Tennessee River, at Glenville and Nantahala, North Carolina . . . *The estimated total addition to the Alcoa power system* is 51,500 Kw, part of which will be produced at the new developments and part from additional water released for us downstream." (emphasis added) (Apparently, the two new projects were finally designed for their actual greater combined capacity, 64,800 Kw.)

Furthermore, for the past 40 years, both Nantahala and Tapoco have been operated as an integral part of the TVA electric system pursuant to the provisions of the Fontana and New Fontana Agreements. Moreover, when Alcoa negotiated these agreements with TVA, it did not bargain for return power from TVA as if Nantahala was an independent power system but rather the attributes of the Alcoa system were melded together with the TVA system for evaluation purposes. In this regard, Intervenors' Ex. DAS-23 is a memorandum of Alcoa's meetings

with TVA respecting negotiations for the NFA wherein the TVA proposals were based on integration into and coordination with the TVA system (Intervenors' Ex. DAS-23, pp. 6-7 of 85).

With Nantahala and Tapoco being thus integrated into and coordinated with the TVA system, it is not appropriate to determine Nantahala's assured capacity by configuring Nantahala as a single independent and isolated system and to use the "largest unit out" methodology. Instead, Nantahala should be treated as part of the TVA system and the reserve margin used by TVA should be applied. TVA does not use a reserve of "largest unit out" but rather uses "the loss of load probability method." (See Intervenors' Ex. DAS-13, p. 1 of 3). Due to the favorable operating characteristics of a hydro system as opposed to a steam system, those characteristics being, for instance, low operating speeds, ruggedly constructed equipment, and restarting capability without auxiliary power, the reserve requirements of a hydro system are very low. Intervenors' Ex. DAS-17, being a portion of the 1980 contract of the Southern Company Services Intercompany Interchange, at page 6 of 6, shows that a 3% hydro reserve is proper.

Using a 3% reserve in place of the "largest unit out" reserve, in this case upwards of 50%, would establish a capacity under most adverse water conditions of 81,800 kilowatts as opposed to Mr. Popovich's calculation of 54,300 kilowatts. This is what Intervenors' witness Springs testified the calculation should be (Vol. 15, Tr. p. 37).

Significant cost is shifted to Nantahala by the unfair and unwarranted limitation of capacity to 54,300 kilowatts. Conversely, that expense, in the form of demand charges paid to TVA, is a concealed benefit to Alcoa.

(3) Nantahala's Upstream Benefits

Nantahala's projects are upstream of Tapoco's projects, except Santeetlah. As a consequence, water that is stored by Nantahala

can be released to flow downstream and be used by Tapoco for production of electricity. Therefore, Nantahala's storage has a value to Tapoco. Granted TVA's Fontana project now lies between the Nantahala and Tapoco projects. However, that does not diminish the value of Nantahala's stored water to Tapoco since, when Nantahala releases water, that water, or its equivalent, can be released by Fontana so as to flow through to Tapoco.

On January 10, 1941, before Fontana was constructed and even before the Fontana Agreement, Nantahala applied to the War Department for a certificate to build the Glenville (now Thorpe) and Nantahala projects, noting that they would be upstream of the Calderwood and Cheoah dams. That application, Intervenors' Ex. DAS-7, at p. 5 of 11, in part, makes this statement about the upstream benefits:

> " . . . It is contemplated that they will store water during the winter months, and will be used in the dry season to produce additional power and also to make available additional water for the developments downsteam . . . "

A 1956 TVA study estimated the upstream storage benefits of the two major Nantahala projects to Tapoco's downstream facilities. As shown by Intervenors' Ex. DAS-9, the Nantahala and Thorpe projects yield a *continuous* relative contribution to Tapoco's Calderwood and Cheoah projects of 4,300 Kw. This is the equivalent of 37,668,000 Kwh annually as an upstream benefit from Nantahala to Tapoco ($4,300 \times 8,760$).

Despite the presence of Nantahala's upstream benefits to Tapoco, when Mr. Popovich devised the 1971 Apportionment Agreement, Nantahala received no credit for this benefit. Of course, the benefit accrued to Tapoco who passed the concealed benefit on to Alcoa.

(4) Nantahala's Entitlement for Operating Its Properties in Accordance with the Fontana Agreement

By the 1941 Fontana Agreement, Nantahala, at the instance of Alcoa, gave to TVA the right, *in perpetuity*, to control the storage and flow of water from its several hydroelectric projects. (See, Item 8, A.G. Popovich Cross-Examination Ex. 3 (original hearing)). Respecting the value of this right, the Fontana Agreement, at page 3, in part, states:

> "Whereas, the most efficient and economical operation of the hydroelectric plants on the Tennessee River and the Little Tennessee River and their tributaries requires the closely coordinated operation of the system of Authority (sic, TVA) with Company's (sic, Nantahala & Tapoco) plants, and such coordinated operation will make possible substantial benefits and economies; and
>
> "Whereas, operation under the provisions of this agreement will aid in the control of floods, the promotion of navigation, and the conservation of stored water; and . . . "

Unquestionably, Nantahala's giving up of rights constituted a loss of considerable value for which loss Nantahala has been entitled to compensation.

With the 1963 apportionment agreement between Alcoa and Nantahala (Item 35, Truett, et al., Judicial Notice Ex. 1 (original hearing), being also Exhibit WMJ-R11), Alcoa agreed to continue to pay to Nantahala monies for Nantahala's loss of those operational rights. Moreover, the agreement clearly stated that TVA was continuing to pay value for those rights, which value is reflected in the TVA return entitlement of the New Fontana Agreement. The 1963 Alcoa-Nantahala Apportionment Agreement at pages 1-2, in part, states:

> "Whereas, the agreement dated August 14, 1941, known as the 'Fontana Agreement' has been superseded in certain respects by a new agreement dated December 27, 1962; and
>
> "Whereas, heretofore Nantahala has received certain payments which represented payments to Nantahala from operating its properties in accordance with the terms of the Fontana Agreement; and

"Whereas, the above-mentioned agreement of December 27, 1962, (sic, NFA) was entered with the understanding among Nantahala, Alcoa and Tapoco, Inc. (a) that the benefits accruing to Nantahala thereunder would include the right to continue to receive payments equal in amount to the above-mentioned payments . . . "

"*Now, therefore*, it is agreed that during the term of the above-mentioned agreement of December 27, 1962:

"1. Alcoa shall pay Nantahala in monthly installments the sum of $89,200 per annum, which amount shall be in addition to the amounts otherwise paid by Alcoa to Nantahala for energy under such power purchase contract as shall be in effect from time to time."

Intervenors' witness Springs testifying on another aspect of this case, used language that is most appropriate to explain this matter:

". . . Thus, the Original Fontana Agreement still continues to confer significant benefits on Alcoa . . ." (Vol. 15, Tr. p. 27).

In the year 1963, in Docket No. E-13, Sub 13, the North Carolina Utilities Commission found the following facts concerning the TVA return entitlement as including a reimbursement to Nantahala. In Item 36, Applicant's Judicial Notice Exhibit (original hearing), at page 8, the Commission stated:

". . . The Evidence offered by Nantahala further disclosed that Nantahala operates under a working agreement between its parent, Alcoa, and TVA (the Fontana Agreement), wherein TVA exercises control of water release in the Nantahala generating system. For this privilege, TVA delivers to Alcoa approximately 25,600,000 Kwh at 100 percent load factor (compensation power) for the credit of Nantahala . . ."

At page 8, the Commission further stated:

"7. Alcoa pays Nantahala for TVA's control of the release of water in Nantahala's generating system at the rate of 3.5 mills per Kwh, based on 25,600,000 Kwh annually. This

payment is below the rate paid by Alcoa to Nantahala for firm power."

Despite the fact that the NFA includes in the TVA return entitlement a reimbursement by TVA for the right to operate Nantahala's projects for which Alcoa previously paid $89,200 annually to Nantahala, when Mr. Popovich devised the 1971 Apportionment Agreement he gave no credit to Nantahala for that entitlement.

Under the terms of the 1971 Apportionment Agreement, Nantahala receives neither an energy credit nor a monetary payment for the right given up. Naturally, since the TVA payment for the operational rights, which is paid with energy in the NFA rate entitlement, did not go to Nantahala, it inured to the benefit of Tapoco. In turn, Tapoco passes this concealed benefit to Alcoa. (It should be noted that 3.5 mills has, for many years, constituted far less than the present value of electric energy.)

(5) Nantahala's Value to the TVA Interconnected System

Another failure of the Apportionment Agreement respecting Nantahala's participation is that the Popovich formula does not consider the proper value to Nantahala of the fact that the Nantahala, Tapoco, and TVA systems are interconnected. Interconnection is of considerable value to TVA completely aside from the fact that Nantahala's rate base includes in it certain assets devoted to the interconnection, which assets are entitled to earn a rate of return. Because Nantahala is not an isolated system, it should be receiving the usual benefits that accrue from coordinated operation. Yet, Nantahala does not receive the usual benefits of an interconnected and coordinated system.

Intervenors' Exhibit DAS-23 consists of many pages of Alcoa memoranda reflecting the path of negotiation between Alcoa and TVA for the New Fontana Agreement. While there are several

references to the matter of interconnection, we refer only to a few which illustrate that interconnection has considerable value. At page 28 of 85, one memorandum says:

> ". . . Copies of our studies were given to TVA and they showed that the new TVA proposal could be supplied from our present system without any apparent consideration given to gains that TVA will realize from integration and the peaking capacity on our system.
>
> "As mentioned above, TVA will check our studies on their own computer and if these studies are confirmed, we will have immediate discussions in an effort to determine what studies should be made to properly determine the benefits of integration, use of our peaking, etc. . ."

Again, on page 30 of 85, Intervenors' Exhibit DAS-23, an Alcoa memorandum states:

> "II. *We do not believe present TVA proposal equitable because*:
>
> a. Our system will alone produce the TVA proposal. . . . We argued, however, that TVA could realize advantages of integration, peaking, etc., and still provide their proposal to us from our system."

Again, on page 34 of 85 of Intervenors' Exhibit DAS-23, another Alcoa memorandum states:

> "There is a strong feeling among the Engineering Department, particularly Messrs. Gnuse, Tompkins, Eagleton, Popovich and others, that the value to TVA of integrated operation is much greater in 1960 than it was in 1941 at the time the contract was negotiated. They have argued that because of this, TVA should be willing to renegotiate the entire Fontana Agreement recognizing the present inequities. . . ."

Of course, during further negotiations, Alcoa was able to derive considerable gain from TVA for the integrated systems factor. We have previously mentioned certain benefits of a coordinated,

integrated operation, such as the need for smaller reserves and, in this case, that TVA actually controls production of generation and storage waters.

However, we have not mentioned the value in integration of Nantahala's projects that are upstream of TVA's Fontana Project. In an integrated system such value is maximized. Since the Fontana Project is located below Nantahala's projects (See Intervenors' Ex. DAS-3) and above the Tapoco projects, other than Santeetlah, the Fontana Project receives the benefit of the storage capability of the Nantahala projects. Indeed, the TVA Tennessee River system receives the benefit of the storage of all of these projects located on the Little Tennessee River system. This is especially true since, under the New Fontana Agreement, TVA has control of all of these reservoirs on the Little Tennessee River system, except the three small projects of Nantahala which are not included. Intervenors' Ex. DAS-9 shows the results of a TVA study of downstream storage benefits. According to this study, the Nantahala and Thorpe units alone added 12,400 Kw of continuous primary power to the TVA system. This is equal to 108,624,000 Kwh per year (12,400 x 8,760 hours) (Vol. 15, Springs pp. 48–49). We have already considered that the upstream Nantahala and Thorpe projects yield a continuous relative contribution to Tapoco's Calderwood and Checah projects of 4,300 Kw, which is 37,668,000 Kwh annually. This benefit to Tapoco should be deducted from Nantahala's total upstream benefit of 108,624,000 Kwh in order to obtain Nantahala's upstream benefit to TVA. After deduction, Nantahala's annual upstream benefit to TVA is calculated to be 70,956,000 Kwh.

Examination of the NFA reveals that the parties cancelled out their respective upstream benefits when that bargain was struck. Since Nantahala provided benefits upstream to both TVA and Tapoco, and TVA provided benefits upstream to Tapoco, it was Tapoco which gained by that mutual cancellation. Certainly, Nantahala lost the benefit of the value of 70,956,000 Kwh

annually. Surely, Nantahala should receive in a joint agreement with TVA the benefit of that integrated upstream storage.

When the 1971 Apportionment Agreement was entered into between Tapoco and Nantahala, Tapoco should have been willing for Nantahala to have an additional 70,956,000 Kwh annually assigned to it as the value of integrated storage, but when Mr. Popovich devised the apportionment formula Nantahala got no such benefit. As a consequence, to Tapoco's benefit, Nantahala was deprived of one value of the interconnection with the TVA system. This concealed benefit flowing from Nantahala to Tapoco is, of course, passed on by Tapoco to Alcoa.

(6) Summary of Detriment to Nantahala from the 1971 Apportionment Agreement

By the 1971 Apportionment Agreement, Nantahala was given no credit for the following:

1. Average production in excess of primary production	66,000,000 Kwh annually
2. Benefits upstream of Tapoco	37,668,000 Kwh annually
3. Entitlement for operating properties under Fontana Agreement	25,600,000 Kwh annually
4. Value to TVA of the interconnected system	70,956,000 Kwh annually
	200,224,000 Kwh annually

In addition, Nantahala received no credit for its peaking capacity of 27,500 kilowatts over the 54,300 kilowatts assigned to it, for which Nantahala must pay demand charges to TVA when monthly demand exceeds assigned capacity.

The North Carolina Supreme Court, in *Edmisten, supra*, at pages 440–441, when considering just the failure of Nantahala to receive benefit for its average production, stated:

> "... Suffice it to say that the assertion that Nantahala's public is fairly served by a contract requiring Nantahala to purchase additional power regardless of the adequacy of its own generation *assaults the common sense of this Court* . . ." (emphasis added)

Now that considerably more of the various detriments to Nantahala have been exposed and fleshed out, it is apparent that the 1971 Apportionment Agreement works an extensive injustice on Nantahala and its public ratepayers, the gravity of which far exceeds even that envisioned by the Supreme Court.

B. *Concealed Benefits of the New Fontana Agreement*

The concealed benefits flowing from Nantahala to Alcoa by virtue of the New Fontana Agreement are entirely different from those previously discussed which flow from the 1971 Tapoco-Nantahala Apportionment Agreement. The basic inequity to Nantahala arising out of the NFA is that the energy entitlement returned to Nantahala and Tapoco from TVA is structured to meet Alcoa's demand for a certain amount of stable electricity for purposes of aluminum production rather than a demand for a public load. Consequently, the NFA returns an average of 218,300 kilowatts of energy at a high load factor with minimal peaking deviation, which load is principally designed to service Alcoa's pot-lines and other production electrical requirements. Even the interruptible and curtailable energy entitlement returned to Tapoco-Nantahala is in increments of wattage that conform to the demands of a pot-line so that, if power is interrupted or curtailed, Alcoa can respond by cutting out a particular pot-line.

Nantahala, on the other hand, has a fluctuating demand for energy which has peaks and valleys. This is typical of a public service load. Nantahala's electrical requirement is for assured, but

constantly, variable amounts. Nantahala needs peaking capacity and its generation projects possess peaking capacity, yet the NFA traded away that peaking capacity to TVA. The Intervenors urge that it would be ridiculous, as a result of enlightened, arm's-length bargaining, to turn over Nantahala's peaking capacity to TVA and then, at such time as its load requires peaking capacity, to buy that same capacity back from TVA at a very high price. The Commission agrees that the detriment resulting to Nantahala from the design of NFA flows to Alcoa as a benefit.

Intervenors' witness Springs testified as to the details of Alcoa's concealed benefits derived under the NFA (Vol. 15, Tr. pp. 39–46). He showed that Alcoa reaped enormous benefits through the improvement of the availability of Tapoco's secondary energy production *from* a level of 42% *average curtailment to an average curtailment* rate of only 8% (Vol. 15, Tr. pp. 39–40).

He also showed that the Tapoco generation statistics reflect the coordination of the Fontana Project and other forms of integration with TVA, which are inconsistent with the isolated system model utilized as the basis for the 1971 apportionment study (Vol. 15, Tr. pp. 43–44). As stated in a memorandum by George Popovich contemporaneously with the negotiation of the NFA:

> "It is my opinion that, to Alcoa, the present proposal (sic, NFA) represents an improvement over the existing Fontana Agreement. In day years this improvement could be substantial . . ." (Ex. DAS 23, p. 59 of 85)

Alcoa was in direct control of the negotiations, and, unlike the Nantahala ratepayers, has had every ability to protect its own interests during the negotiations (Vol. 15, Tr. p. 46–47). Respondents cannot now be heard to claim that they are dissatisfied with the NFA so as to place the cost responsibility for the deficiencies of that agreement upon Nantahala's ratepayers.

One reason the NFA may have been designed so exclusively to meet Alcoa's needs, to Nantahala's detriment, was because when the NFA negotiations were underway, the parties contemplated

the sale of Nantahala's distribution system to Duke. By the sale to Duke, Nantahala would have been left with its generation but would have been without a public service load. Nantahala would then have taken its NFA entitlement and delivered it all to Alcoa. Accordingly, the power Nantahala would have gotten under the NFA would have been satisfactory for delivery to Alcoa irrespective of quantity and design.

A sale of Nantahala's distribution system to Duke had been approved by the North Carolina Utilities Commission and the approval Order, in turn, had been approved by the Superior Court. It was not until the year 1963 that the Supreme Court stopped the sale, which date was after the New Fontana Agreement had been executed. See *Utilities Commission* v. *Membership Corp.*, 260 N.C. 59, 131 SE 2d 865 (1963). Prior to the Supreme Court's action, Alcoa personnel had believed that the sale to Duke was to be approved. Thus, in an Alcoa memorandum dated May 27, 1960, being Intervenors' Ex. DAS-23, p. 2 of 85, it is recorded:

> ". . . They (sic TVA) asked us the status of the sale of Nantahala to Duke. We told them that the matter was at a standstill at the present time but we were continuing our efforts to complete the transaction and we expected that the sale would take place perhaps within the next year . . ."

In a memorandum of August 23, 1960, being page 15 of 85 of Intervenors' Ex. DAS-23, it is stated:

> "One final note, the entire TVA proposal is based upon the sale of the Nantahala Power Company. TVA proposed that if the sale was not complete at the time this new proposed contract becomes effective, they would increase the power available to us under the purchase contract to whatever amount is necessary for us to handle the Nantahala peak. This would be done on a temporary basis and would be reduced concurrent with the transfer of the Nantahala properties to Duke."

In another memorandum of November 6, 1962, being Intervenors' Ex. DAS-23, p. 83 of 85, which is the final memorandum

after completion of all negotiations for the NFA, the following is written:

> "... In my opinion it will be preferable for us to sell the Mission Plant to TVA whenever we transfer the Nantahala properties to Duke ..."

These memoranda clearly establish that during the entire 2½ year period over which the NFA was negotiated between TVA and Alcoa, both parties contemplated that Nantahala's entire public service load would be sold to Duke. Based on this assumption, the entire TVA return entitlement to Alcoa was structured in such a manner as to meet Alcoa's load requirements for aluminum production. In no manner was the NFA structured to meet Nantahala's needs (Vol. 15, Tr. p. 47). We support this obvious conclusion even further by noting that on January 1, 1963, five days after the signing of the NFA, Alcoa and Nantahala executed an agreement between themselves to reflect "understandings" made between the affiliated companies at the time of the signing of the NFA. In this agreement, being Item 35, Truett, et al., Judicial Notice Ex. 1, also being Applicant's Exhibit WMJ-F11, it was stated:

> "Whereas, the above-mentioned agreement of December 27, 1962 was entered into with the understanding among Nantahala, Alcoa and Tapoco, Inc. (a) that the benefits accruing to Nantahala thereunder would include the right to continue to receive payments equal in amount to the above-mentioned payments and, in addition, the right each month to an amount of energy which, together with its generation at plants not under said agreement, would be equivalent to its total acutal generation but in no event less than one-twelfth of its annual primary generating capability, and (b) that certain obligations and benefits thereunder would be performed and enjoyed as herein set forth ..."

The significance of this latter agreement is that since the NFA was obviously structured to Alcoa's need rather than to Nantahala's, Alcoa and Nantahala agreed that Nantahala could

obtain certain power entitlements from the TVA return and, additionally, receive other monetary benefits from Alcoa.

Also, Intervenors' expert witness Springs testified, in part, as follows:

> "Throughout the negotiations, TVA and Alcoa had every reason to assume that NP&L's distribution system would soon be sold off to Duke Power Company. NP&L did not even have a representative at any of the negotiating sessions. Alcoa secured the benefits of being integrated with TVA, including the benefit of storage releases from Fontana which are *vital to the operating of Tapoco's facilities*. ... The 1963 Apportionment Contract shows in its face that the New Fontana Agreement was never intended as a 20-year power supply for NP&L public load. It appears that NP&L's officers and consultants were primarily concerned with the effect of the Agreement on the ongoing rate case and transfer cases before the NCUC and not with the interest of NP&L ratepayers over the 20-year period of Agreement." (emphasis added) (Vol. 15, Tr. p. 47)

The foregoing evidence of record clearly demonstrates that the NFA was tailored to meet Alcoa's aluminum production needs without consideration of Nantahala's public service needs, that the NFA return entitlement from TVA is not suitable for Nantahala's operations (although it is very suitable for aluminum production) and that Nantahala's participation in the TVA return entitlement could not be secured without a monetary supplement from Alcoa to Nantahala. The Intervenors have not established how much better Nantahala would have fared if the NFA had been negotiated for a TVA return suitable for servicing a public load, nor have they attempted to do so. Such proof is unnecessary. It is too hypothetical to conjecture as to what quantum and type of return energy Nantahala should have negotiated for and as to what TVA would have been willing to agree upon. Nantahala was not designed as, and is not in reality, a separate

utility system but, rather, is part of an integrated Alcoa system with Tapoco. As expert engineering witness Springs testified:

> ". . . I agree with a rolled-in-cost-of-service approach for NP&L and Tapoco, because it is impossible to separate out the functional relationship between the generating resources operated by these companies and the load they each serve." (Vol. 15, Tr. p. 56)

Summarizing the foregoing inequities to Nantahala which result from the New Fontana Agreement, it can be stated that the TVA return entitlement was entirely designed for Alcoa's industrial load and was not suitable for Nantahala's public service responsibilities. Nantahala needed peaking capacity and had peaking capacity from its own generating stations, yet Nantahala gave up that capacity with the result that it must buy high cost power from TVA to meet its peaking responsibilities. The extra costs thus incurred by Nantahala inure to the benefit of Alcoa. For instance, by the 1963 Alcoa-Nantahala Apportionment Agreement, even Alcoa recognized, in fact, the unfairness to Nantahala produced by the NFA and agreed to pay an annual cash settlement of $89,200, to Nantahala to offset some of the inequities.

Any regulatory reformation of the NFA to properly award to Nantahala its just entitlements would, of necessity, be somewhat hypothetical. At this late stage of the case, and particularly with an alternative solution available, such reformation should not be attempted. The roll-in technique avoids the need for complete identification of inequities and is nicely suited as a proper alternative to reformation of contracts. The Supreme Court, in *Edmisten, supra,* at p. 443, called for use of the roll-in in this case, if beneficial to the public, with this language:

> ". . . This device does nothing more than recognize that the two corporate entities ought, for rate making accounting purposes, be treated as the one electrical power producing and distribution system which, in fact, they are. If then unlawful preferences are indeed accorded to Alcoa to the detriment of Nantahala's customers because of the separate corporate structures and the inter-corporate apportionment agreements, this rate making device would seem to eliminate them. . . . The case is remanded with directions to the Commission to obtain and consider information and data showing what Nantahala's cost of service to its customers would be if this method of rate making were used and whether Nantahala's customers would benefit thereby."

Further, the Commission notes that while Nantahala's facilities were obligated as provided under the Original Fontana Agreement, it was not even permitted to be a signatory thereto. Even though it was a signatory to the New Fontana Agreement, it did not participate in the negotiations of that agreement. Moreover, Nantahala's employment contract with its president, William M. Jontz, provides, in pertinent part:

"*Section 2. Duties and Responsibilities.* Employee is hereby employed by Nantahala as Chief Executive Officer of Nantahala and shall act in such capacities pursuant to the supervision and direction of the Board of Directors of Nantahala (hereinafter sometimes referred to as the 'Board'). Major general objectives of such employment during the term hereof are for the Employee to:

> (a) Manage Nantahala as a public electric utility, within the restraints of regulatory controls, so as to achieve a profitability consistent with other public electric utilities in North Carolina.
>
> (b) Develop plans for the possible sale or other disposition of Nantahala and execute such plans should the Board of Directors of Nantahala so direct.
>
> (c) Accomplish (a) and (b) above so that there is little or no adverse impact on the operations and assets of Nantahala's parent company, Aluminum Company of America, and its subsidiaries in North Carolina, including, but not limited to, the generation and transmission of electric power by Tapoco, Inc. and Yadkin, Inc. and the operations of the Badin Works of Aluminum Company of America."

* * * * *

"*Section 3. Compensation.* For the performance on his duties and responsibilities, Employee shall receive the following compensation:

> (a) *Base Salary* . . . (NOTE: this subparagraph is not further here quoted, but it provided for probable annual achievement awards.)
>
> (b) *Achievement Award* To be determined annually by the three-member Aluminum Company of America group among the Board of Directors of Nantahala and to be based on the performance of Employee in reference to the major general objectives set forth in Section 2 hereof. The probable annual achievement awards for the respective contract years are set forth above."

* * * * *

"*Section 6. Nondisclosure.* . . . Nor shall Employee in any manner, directly or indirectly, aid or be a party to any act, the effect of which would tend to divert, diminish or prejudice the good will or business of Nantahala or of Nantahala's parent company, Aluminum Company of America and its subsidiaries in North Carolina, Tapoco, and Yadkin, Inc."

As the record of this proceeding prior to remand established— and as the Supreme Court found (299 N.C. at page 435):

> "The transmission facilities of Nantahala and Tapoco are integrated and interconnected into a single system. Alcoa controls the ultimate operation and accounting policies of both utilities. The chief executive officers of both Nantahala and Tapoco report directly to an Alcoa vice president. Members of the board of directors of both utilities are employees of Alcoa."

Alcoa's dominance is obviously and frequently documented in the results of various arrangements it has caused Nantahala and Tapoco to enter into. Such dominance has caused detriment to Nantahala and has resulted in the passing of concealed benefits to Alcoa.

Therefore, based upon the foregoing and upon careful consideration of the entire evidence of record, the Commission concludes that it should reject the companies' proposed allocation methodology in that said methodology in all material respects is based upon the New Fontana Agreement and the Tapoco-Nantahala Apportionment Agreement.

Before going forward with a specific discussion of the Intervenors' allocation methodology, it is appropriate to examine two questions which were vigorously contended as between Alcoa and Tapoco on the one hand and the Intervenors on the other hand:

First, does Tapoco wheel power for Alcoa?

The companies (Alcoa and Tapoco) contend that the $31 million of power purchased by Alcoa directly from TVA can become a part of the Nantahala-Tapoco system simply because the power was allegedly "wheeled" by Tapoco from TVA to Alcoa.

Alcoa purchases supplemental power from TVA. Alcoa and Tapoco contend that the TVA purchased power is wheeled to Alcoa through Tapoco's facilities. The Intervenors rigorously dispute this contention on the grounds that there is neither wheeling in fact, nor a contract between TVA and Tapoco, nor Alcoa and Tapoco, nor Alcoa and TVA for Tapoco to perform wheeling services, nor is there a charge made for wheeling services.

Company witness Buchanan, "an accounting executive with the title of Assistant Controller-Financial Accounting" for Alcoa (Vol. 2, Tr. p. 86), testified that:

> ". . . As Assistant Controller of Alcoa, I have general responsibility for the financial accounting for Alcoa and its subsidiaries, and as such have responsibility for the books and records and financial policies of Tapoco and Nantahala." (Vol. 2, Tr. p. 87)

On cross-examination he was asked:

"Q. Does Tapoco ever receive a fee for the wheeling service you have just described?

A. I'm not aware of any fee, no, sir." (Vol. 2, Tr. p. 143)

Immediately after that testimony, Company Counsel Jones argued:

"... that the record in this proceeding carries with testimony of the earlier witness, Mr. George Myers, President of Tapoco, a complete discription of the wheeling, recognition that the wheeling is pursuant to Tapoco's FERC rate schedule No. 4, I believe it is, although the record will speak for itself . . ." (Vol. 2, Tr. pp. 143-144)

However, reference to the prior testimony of Mr. Myers fails to bear out Counsel Jones' contention. Mr. Myers had testified:

"Q. Do you know whether Tapoco has an FERC rate schedule covering its wheeling of Alcoa's purchases from TVA to the other two plants?

A. I guess I'm not familiar with what that rate schedule is. I know the basis on which it is done but I don't know the exact rate schedule." (E-13, Sub 29, August 29, 1980, Vol. 1, Tr. pp. 65-66)

Switching back to accounting officer Buchanan, inquiry was made of him as to whether he could identify the alleged wheeling contract. On cross-examination Mr. Buchanan testified:

"Q. All right. Now, you are saying then I gather that Tapoco transmits TVA to Alcoa. Is that correct?

A. Yes, sir.

Q. All right. Now, will you tell the Commission, please, sir, on what agreement you rely for making that statement and have you seen that agreement?

A. I have not seen the agreement.

Q. You don't know it to be a fact, do you?

A. No, sir." (Vol. 2, Tr. p. 139)

Thus we observe that neither the President nor chief financial officer of Tapoco was familiar with the alleged wheeling contract. Moreover, if there is a wheeling contract, certainly it does not provide compensation to Tapoco for any wheeling service performed.

Wheeling has a particular definition. In *Town of Norwood* v. *FERC*, 587 F. 2d 1306 (1978), at page 1307, Note 2, the Court defined wheeling this way:

" . . . wheeling is an industry term which denotes the use of one utility's transmission facilities to transmit from another utility."

In *Idaho Power* v. *FPC*, 346 F. 2d 956 (1965), at page 957, Note 1, the Court said:

" 'Wheeling' is the transmission of one company's power over another company's system."

And, see *Utah Power & Light Co.*, v. *Morton*, 504 F. 2d 728 (1974).

These definitions of "wheeling" are compatible with the definition of "wheeling" within the electrical industry. Thus, within the electrical industry "wheeling" is defined as follows:

"Wheeling service—the use of the transmission facilities of one system to transmit power of and for another system." (Intervenors' Judicial Notice Ex., Edison Electrical Institute, "Electric Utility Rate Making and Load Management Terms," dated Sept. 11, 1978, p. 83)

The companies (Alcoa and Tapoco) subsequently had their witnesses identify a contract between Alcoa and Tapoco as the one governing the alleged "wheeling" arrangement. Buchanan testimony, Vol. 3, Tr. pp. 1-2; Vander Veen testimony, Vol. 4, Tr. pp. 2, 11-14. However, that contract (Intervenors' Buchanan Cross Exam. Ex. 2) does not mention either "wheeling" or "trans-

mission" to support the companies' position. Instead, the witnesses must interpolate other words as including within their framework "wheeling." Such interpolation was accomplished by accounting witness Buchanan in this fashion:

"Q. I will hand you the document, sir, and ask you, please, to point out to me wherein in this document you find language that supports that characterization of it, please?

A. The contract reads to the effect under which power delivered to Alcoa, Tapoco and other sources, is transferred and switched at the high voltage substation facilities of Tapoco, located adjacent to the Alcoa, Tennessee, works of Alcoa. And it is my understanding that that relates to the wheeling between the various plant locations of the Alcoa, Tennessee, plant.

Q. That is your understanding. It doesn't say that, does it?

A. Not in those words, no, sir.

Q. It doesn't say that in any words, does it?

A. No, sir."
(Vol. 3, Tr. pp. 2-3)

Company Witness Vander Veen testified that transforming and switching constituted the alleged wheeling.

"Q. . . . I'm going to read to you, sir, the initial paragraph lower case 'a.' quote, 'At the substation facilities mentioned above, Tapoco will perform such necessary transformation and switching of power delivered to Alcoa as Alcoa shall direct.' End quote. I ask you first, sir, is there anything in that language that relates to transmission?

A. Yes, sir. Those functions, the switching functions, if I could see the word please. Yes, such necessary transformation and switching of power—

Q. (Interposing) Transformation?

A. Transformation and switching, those are transmission functions, sir." (Vol. 4, Tr. p. 5)

Later, the so-called wheeling was pin-pointed to a single location.

"Q. Does either pay the other any wheeling charge whatever for the transmission of that power from any generating source to the Tapoco substation?

A. The wheeling is at the substation.

Q. That's the only point?

A. Yes, sir."
(Vol. 4, Tr. p. 11)

The Agreement is not in actuality a wheeling agreement since "wheeling" requires transmission and the agreement is dealing with transformation and switching.

In actuality, there is no wheeling of power for Alcoa or TVA by Tapoco.

In further support of this position, the Commission takes note of the fact that Tapoco sells all of its power, i.e., its NFA return entitlement from TVA, to Alcoa. Intervenors' Buchanan Cross-Examination Ex. 3 is that 1963 sales arrangement.

The companies urge that the Alcoa purchases from TVA be considered in the Nantahala-Tapoco electrical system as the result of the following paragraph in the alleged wheeling contract from Tapoco to Alcoa.

"It is desirable to reduce to writing the arrangement between Tapoco, Inc. (Tapoco) and Aluminum Company of America (Alcoa) under which power delivered to Alcoa (from Tapoco and other sources) is transformed and switched at the high voltage substation facilities of Tapoco, located adjacent to the Alcoa, Tennessee works of Alcoa. Accordingly it is proposed that we agree as follows:

(Intervenors' Buchanan Cross-Examination Ex. 2)

For accounting purposes that contractual language obviously doesn't carry with it a wheeling obligation since no wheeling fee is collected. Even the president of the company isn't aware of a wheeling obligation by virtue of that contract. Even if the contract marginally constitutes a wheeling arrangement, it should not be used as a ploy to dump Alcoa's purchases from TVA into the Nantahala-Tapoco electrical system.

Perhaps the truth of the separateness of Alcoa's TVA purchases from the Nantahala-Tapoco system is best summed up by this honest and final testimony of the companies' witness Dr. Leininger when he testified:

> "Q. All right. Now you say each must employ additional TVA power to meet its customers' total load. When you make that statement, are you saying that Tapoco supplementally to the entitlements it gets out of the Fontana Agreement must acquire TVA power to supply to Alcoa?
>
> A. I suspect its inartful wording. Alcoa does its own purchasing as I understand it.
>
> Q. Did you understand that when you wrote this sentence?
>
> A. Yes, sir.
>
> Q. Why did you write it this way then?
>
> A. Because I wasn't careful when I wrote it."
> (Vol. 14, Tr. p. 97)

Therefore, based upon the foregoing and other evidence of record, the Commission concludes that it would be completely erroneous to find either (1) that the Alcoa purchases from TVA are "wheeled" by Tapoco to Alcoa or (2) that such power, if wheeled, enters into and becomes a part of the Nantahala-Tapoco unified public utility system.

The second question is: Are Alcoa's purchases of power from TVA part of the Nantahala-Tapoco integrated system?

The record reflects, during the year 1975, that Alcoa bought some $31 million in electric power from TVA which Alcoa used solely for its industrial plant operations in Tennessee. The record establishes without dispute that neither Nantahala nor Tapoco generated, bought, sold, acquired, or had any right to use that electricity. Alcoa retained 100% control over such power at all times. Where Nantahala and Tapoco, as public utilities, do not generate, acquire, buy, sell, or have the right to control the use of electric power, no such ungenerated, unacquired, unbought, unsold, and uncontrolled power can be a part of the Nantahala-Tapoco public utility system.

However, assuming *arguendo* the companies' contentions regarding wheeling are correct there is no showing that the power is at all integrated with the combined system. The further issue is whether the power purchased by Alcoa directly from TVA has become available to the Nantahala-Tapoco system to meet its public service load. If Tapoco had any contact at all with the Alcoa purchases from TVA, at most, the Tapoco activities are limited to Transforming and Switching, which activities do not rise to the level of transmission as required for wheeling. However, if it is assumed, again for purposes of argument, that Tapoco did "wheel" the Alcoa Power purchased from TVA, such power should not be treated as a part of the Nantahala-Tapoco unified system because the power never entered into the Nantahala-Tapoco unified system. Even if the TVA power enters Tapoco's substation at Alcoa, Tennessee, such power does not traverse the Nantahala-Tapoco electrical system. Instead, at most, that power is released by TVA at the Alcoa substation where it is transformed and immediately switched over to Alcoa's lines. Such power could never be made available to serve any portion of the public service load. Most fundamentally, its identity as Alcoa power is never lost since Alcoa never releases control of the use of that power in its capacity as ultimate consumer of that power from TVA.

The contract between Alcoa and TVA (Company Exhibit BDC-3) does not mention delivery of the TVA purchased power by the Nantahala-Tapoco system but rather describes delivery direct to Alcoa. Page 2, paragraph 3, of the contract reads as follows:

> "3. *Delivery of Power.* Power delivered hereunder shall be 3-phased alternating current at a frequency of approximately 60 cycles per second and shall be delivered at company's Alcoa Primary Substation at a normal voltage of 162 Kw or such other voltage as may be agreed upon by the operating representatives. Except for temporary periods of abnormal operating conditions, voltage variations will not exceed 5 percent up or down from the normal voltage."

Even when interpreting "Company's Alcoa Primary Substation" to mean a Tapoco substation, obviously Alcoa does not lose any control over that purchased power by permitting it to become a part of the Nantahala-Tapoco unified system.

Moreover, Alcoa does not pay a fee, even a nominal one, to Tapoco for the so-called "wheeling" service—if there is a "wheeling" service. This is made clear by the testimony of companies' witness Buchanan.

> "Q. Then Tapoco, the combined Nantahala-Tapoco system or entity, however you want to characterize it, neither billed nor received a penny with respect to TVA sales to Alcoa. Isn't that correct, sir?
>
> * * * * *
>
> "A. You are correct in the statement in the manner in which you said it. Yes, sir—." (Vol. 2, Tr. pp. 118-119) (See, Vol. 2, Tr. p. 134)

Additionally, Tapoco failed to report on its Form 1 to FERC that it wheeled $31 million of power to Alcoa (Vol. 2, Tr. p. 134). One reason for this "failure" is that TVA bills Alcoa directly for the power. Tapoco does not become involved with the purchased power, either financially or through line losses.

The Commission, based upon the foregoing and other evidence of record, concludes that purchases of power from TVA by Alcoa are not cost applicable to the Nantahala-Tapoco integrated system properly assignable in any way to said system's North Carolina retail operations.

Allocation of the costs of the Nantahala-Tapoco unified system involves several aspects, namely, (a) allocation of the $31 million of Alcoa purchases from TVA and (b) the mathematics of allocation. We will treat these two items separately.

A. *Allocation of the $31 Million of Alcoa Purchases From TVA*

The Intervenors contend and the Commission concurs that should the $31 million of Alcoa purchases from TVA be rolled into the Nantahala-Tapoco unified system, those purchases should be allocated entirely to Alcoa.

To illustrate the necessity of the allocation entirely to Alcoa, let us suppose that Tapoco purchased the power in question under a contract identical to the Alcoa-TVA contract. In such an instance there is no way in which that contract can be turned from a specific requirements contract into a general requirements contract. The Alcoa-TVA power purchase agreement (Applicant Exhibit BDC-3), at page 2 (discovery p. 200082), states:

> "2. *Availability of Power.* Subject to the other provisions of this contract, TVA shall make available to Company hereunder 'firm power' in the respective amounts specified for the periods indicated in the tabulation set forth below, which amounts shall be 'firm contract demand' under this contract for such periods.

	Amount of Firm Power Available
August 1, 1969, through December 31, 1972	30,000 Kw
January 1, 1973, through July 31, 1979	350,000 Kw

> Except as otherwise provided in this contract, TVA will make power available to company continuously hereunder during each of the above periods in the amount of the firm contract demand specified for that period. The firm power available hereunder will be deemed to be taken and used by the Company at 100 percent load factor."

The terminology of the contract is not suitable for a public utility load, which needs variable amounts of energy, but rather is suitable only for a specific customer having stable needs. Thus, even if the contract were considered to be a Tapoco contract, the contract is so tailored to a specific customer that the costs associated with it would have to be specifically assigned to the customer. This logic is confirmed by the testimony of Intervenors' witness Springs wherein, on cross-examination by the companies, he testified:

> "Q. That power was purchased for that one customer, is that right?
>
> A. That is right. It would be a pass-through because it is identified as related to that customer. It is not a function of a utility." (Vol. 15, Tr. p. 81)

In this case, in order to escape a specific or pass-through assignment of costs of the TVA purchases to Alcoa, the contract would have to be modified to be a Tapoco purchase contract with modified terms providing for power amenable to a public utility operation. Neither of those facts has or will happen. For purposes of this case, the companies are bound to the existing contract to which Tapoco is not a party and which is an Alcoa specific requirement rather than a general requirements contract. As companies' witness Cockrell testified:

> ". . . Alcoa purchases Tapoco's entitlements and acquires the remainder of its needs from TVA under a companion contract." (Vol. 5, Tr. p. 62)

Alcoa is not a small industrial company which would have only a marginal effect on Nantahala but rather a massive company with worldwide operations. Gross revenues in 1980 were $5.2 billion (Vol. 2, Tr. p. 110), which amount is more than 300 times the gross revenues of Nantahala. The Alcoa, Tennessee, aluminum reduction facilities, as late as 1952, when the book *An American Enterprise* was written (Intervenors' Exhibit DAS-1, p. 1 of 14), was the largest in the world (Intervenors' Exhibit DAS-1, p. 8 of 14). Furthermore, the Alcoa, Tennessee, aluminum reduction plant is merely one of many for Alcoa. See Applicant's Exhibit BDC-1 for a list of Alcoa's nine aluminum production plants which have an annual average need of 28,557,600,000 Kwh of electricity (3260 Mw x 24 x 365). By way of comparison, Alcoa's annual aluminum production need for electricity approaches in size the combined North Carolina production of both Duke Power Company and Carolina Power & Light Company.

Alcoa is a gigantic energy consuming entity nationwide and its impact on western North Carolina is likewise enormous. If the Alcoa, Tennessee, load that is purchased from TVA were to be assigned as a function of the Nantahala-Tapoco system, the impact of that load on the system would be so enormous as to warp and twist the costing technique of the entire system. Indeed, if the Nantahala-Tapoco system tried independently to service the Alcoa-Tennessee load, it would have to double its system size. Yet no effort has been made by the system to do that. Neither Nantahala nor Tapoco has built a facility in over 20 years. Alcoa is entirely dependent upon TVA for its supplemental load.

B. *The Mathematics of Allocation*

Although the Commission has previously rejected the companies' use of demand and energy entitlements contained in the NFA and the Apportionment Agreement as a basis for the derivation of demand and energy allocations, the Commission

believes that the manner in which the companies employed the data contained in said agreements is worthy of further comment.

The NFA return entitlement from TVA is an annual average of 218,300 Kw of which Nantahala is assigned 41,300 Kw leaving the balance, less line losses, for Tapoco. While 90 Mw of the entitlement is curtailable for as long as five months annually, total energy curtailed is limited to 1,260,000,000 Kwh during the entire 20-year term of the agreement (Item 9, A.G. Popovich Cross-Examination 4, pp. 6-7). Of course, if power is curtailed in one year it will have to be made up in the other years in order for TVA to supply an annual average of 218,300 Kw over the 20-year term. Despite this, for allocation of demand costs to Tapoco when computing the system peak, Company witness Vander Veen did not include any portion of the 90 Mw curtailment entitlement for determining the peak demand upon the system. Witness Vander Veen testified:

> "... Consequently, for demand cost allocation purposes, I used only firm power available to meet system peak, thus removing the amount of capacity that can be curtailed and interrupted from the capacity available to serve system peak load. ..." (Vol. 3, Tr. p. 71)

The upshot of this technique is to render the 90 Mw valueless for meeting the system demand at any time, even during years when there is no curtailment and, indeed, when there may be additional make-up demand.

Mr. Vander Veen also took out of the Tapoco demand allocation 1/6th (i.e. 15 Mw) of the 90 Mw interruptible power returned by TVA under the NFA. A total of 105 Mw was thus taken out of Tapoco's demand allocation for both the curtailable and the interruptible power (Vol. 3, Tr. p. 71).

The effect on Nantahala of Mr. Vander Veen's technique will be to dramatically increase Nantahala's proportionate share of the demand charges. A careful analysis of Mr. Vander Veen's

allocation calculation shows the following: His system peak is 430.2 Mw, as to which there is improperly included 235 Mw representing Alcoa's TVA purchases. If we deduct the 235 Mw from the system peak of 430.2 Mw, we obtain a Nantahala-Tapoco system peak of 192.20 Mw of which Mr. Vander Veen calculates Nantahala's share to be 107.2 Mw while Tapoco's share is only 88 Mw (Vol. 3, Tr. p. 772). Thus, Nantahala must share a considerably higher demand allocation than Tapoco even though Nantahala and Tapoco both take under the NFA and Tapoco takes three times as much power as Nantahala.

Witness Springs explained how Mr. Vander Veen's approach unfairly burdens the public customers by requiring them to bear costs properly assignable to Alcoa.

> "Mr. Vander Veen assigns customer cost by utilizing the entitlements of the New Fontana Agreement to derive the system demand instead of utilizing the total demands placed upon the Tapoco and NP&L generation. Although the New Fontana Agreement reshaped the available power supply to suit Alcoa's load requirements, the entitlements result from the investment, maintenance, and operation costs necessary to make the hydroelectric generation of NP&L and Tapoco available for TVA's demands.
>
> The fallacy of Mr. Vander Veen's approach is illustrated by the demand credit he assigns to Alcoa because of the interruption and curtailment features of the New Fontana Agreement entitlements. This is a misapplication of an allocation principle. Although it is not unusual for an industrial customer to receive a credit for accepting interruptible power, the rationale for this is that the utility providing the service to that customer will save the cost of carrying reserves. The ability of a utility to provide such credits is limited by its need for reserves. There should be no credit for interruptions which do not result in cost savings to the supplying utility. Mr. Vander Veen's demand credit unfairly assigns to other customers the fixed costs necessary to generate the power traded to TVA for this curtailable and interruptible power. The fixed costs of investment, operation, and

> maintenance for these plants do not cease when TVA curtails delivery to Alcoa under the New Fontana Agreement contractural arrangements." (Vol. 15, Tr. pp. 59-60)

Mr. Vander Veen arrived at his allocations based upon the premise that the NFA and the 1971 Apportionment Agreement were negotiated in the best interest of Nantahala's public service load. Nothing could be further from the truth! (Vol. 15, Tr. p. 39)

The NFA was entered into for and structured to meet Alcoa's load requirements. Nantahala was not even present during negotiations (Intervenors' Exhibit DAS-25). In essence, the NFA is a trade-off of certain firm power and secondary power, available less than 50% of the time, for lesser amounts of firm and secondary power that are curtailable and interruptible but available more than 50% of the time, since any power available more than 50% of the time is useable by Alcoa in its aluminum smeltering operations (Vol. 15, Tr. p. 40). The trade-off result is a considerable improvement in the value of Tapoco's energy useable for Alcoa's aluminum production (Vol. 15, Tr. p. 45). The trade-off has no value to the public load. Alcoa (Tapoco) should, therefore, take full cost responsibility for the demand-related costs associated with the capacity traded off (Vol. 15, Tr. p. 61).

The Vander Veen demand allocation technique would result in a gross inequity to Nantahala and to public load customers. A proper allocation technique should not be inequitable either to Nantahala or to Tapoco.

With the terms of the NFA having been structured to meet Alcoa's industrial needs and not Nantahala's public service needs, it is improper to allocate demand and energy costs based upon the TVA return entitlements. Rather, demand and energy charges should be based upon the capabilities and the needs of Nantahala and Tapoco outside of the TVA return entitlements. That is the very purpose of the roll-in study.

The combination of the NFA and the 1971 Apportionment Agreement forces Nantahala to purchase additional power irre-

spective of its production capacity. We reiterate what the Supreme Court said in *Utilities Commission* v. *Edmisten, supra,* at page 440:

> ". . . Suffice it to say that the assertion that Nantahala's public is fairly served by a contract requiring Nantahala to purchase additional power regardless of the adequacy of its own generation assaults the common sense of this court. Nantahala's customers should not be denied the benefit of their utility's fairly regular harvests of abundant energy."

The Commission also points out again that the purpose of the roll-in method of ratemaking is to "cancel" or at least to "true-up," concealed benefits. See, *Utilities Commission* v. *Edmisten, supra,* at pages 437-443.

The Intervenors contend that the following data represents the capabilities and needs of the Nantahala-Tapoco unified system, and that such data is appropriate for use in the allocation of demand related costs.

A. Dependable Capacity for NP&L Projects (See Intervenors' Exhibit DAS-4)	85.4 Mw
B. Dependable Capacity of Tapoco Projects (See Intervenors' Exhibit DAS-4)	302.8 Mw
C. Total (A + B)	388.2 Mw
D. Less Reserve at 3%	11.3 Mw
E. Net *Firm* Capacity Available to Meet the Load (C-D)	376.9 Mw
F. Purchase Power of NP&L from TVA (NP&L FPC Form No. 1, 1975, page 422)	50.4 Mw
G. Losses on F above (assumed 5%)	2.5 Mw
H. Total Net *Firm* Capability Available at Generation to Meet the System Requirements of NP&L and Tapoco (E + F + G)	429.8 Mw

See Vol. 15, 54, p. 62.

Nantahala's peak load during the test year was 105,747 Kw which figure represents its maximum need during the year. Nantahala's demand responsibility for costing purposes can be calculated by dividing the total Nantahala-Tapoco system demand responsibility into Nantahala's maximum demand responsibility. Thus, dividing 429,800 Kw into 105,747 Kw produces a Nantahala demand allocation of 24.60% of the system's demand responsibility (Vol. 15, Tr. p. 634). Using this allocation factor, 24.60% of the Nantahala-Tapoco unified system demand costs should be assigned to Nantahala and the balance to Tapoco.

While demand charge allocations must be computed based on production capacity and capacity needs, energy charge allocations must be computed based upon the average energy available for the Nantahala-Tapoco unified system plus Nantahala's purchases. The Intervenors contend that the following data represent the average energy available to the combined system including Nantahala purchases, and that such data is appropriate for use in the allocation of energy related costs.

A. Average Energy Available from NP&L Projects (New Fontana Agreement Apportionment Study) (Intervenors' Exhibit DAS-12)	391,500 Mwh
B. Average Energy Available from Tapoco's Projects (New Fontana Agreement Apportionment Study) (Intervenors' Exhibit DAS-12)	1,373,600 Mwh
C. Total Average Energy Available from NP&L and Tapoco's Projects (A + B)	1,765,100 Mwh
D. NP&L Purchase of Energy from TVA (NP&L Form No. 1, page 422)	81,265 Mwh
E. Losses on D above (assumed 5%)	4,063 Mwh
F. Total Average Energy Available to Meet System Load (C + D + E)	1,850,428 Mwh

See, Vol. 15, Tr. pp. 63–64.

Nantahala's energy requirement during 1975 was 453,548 Mwh. Nantahala's energy responsibility for costing purposes can be calculated by dividing the total Nantahala-Tapoco system energy responsibility into Nantahala's energy responsibility. Thus, dividing 1,850,428 Mwh into 453,548 Mwh produces a Nantahala energy responsibility of 24.51% (Vol. 15, Tr. pp. 64–65). Using this allocation factor, 24.51% of the Nantahala-Tapoco unified energy costs should be assigned to Nantahala and the balance to Tapoco.

The demand allocation factor of 24.60% and the energy allocation factor of 24.51% were used by Intervenors' expert witness Solomon in allocating the Nantahala-Tapoco total system demand and energy related costs to said system's North Carolina retail operations.

The Commission, after having very carefully considered the entire evidence of record with respect to the assignment of cost including cost allocation techniques and/or methodologies, concludes that the methods and procedures employed by the Intervenors with respect hereto are, in all material respects, proper and that said methods and procedures should be adopted for use herein.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 7, 8, 9, 10, AND 11

There is no disagreement between the parties with respect to the reasonable original cost, the replacement cost, the depreciation reserves, or the allowance for working capital applicable to the total combined operations of the Nantahala-Tapoco system. There is, however, a difference of opinion as to the proper amounts of the aforementioned costs and reserves applicable to the combined system's North Carolina retail operations. This difference results from the application of different allocation methodologies which have been previously discussed and from the

Intervenors' contention that no fair value increment should be assigned to the property of Tapoco. As previously stated, the Commission has adopted the allocation methodology proposed by the Intervenors for use herein. Therefore, it is entirely consistent and proper for the Commission to adopt North Carolina retail levels of investment and depreciation reserve resulting from application of said Intervenors' allocation techniques. With respect to the Intervenors' contention that no fair value increment should be added to the original cost of Tapoco's property, the Commission is compelled by G.S. 62-133, as it was structured during the test year and at the time of the Commission's initial decision in this matter, to reject the Intervenor's position in this regard.

Therefore, based upon the foregoing and the entire evidence of record, the Commission concludes that the reasonable original cost less depreciation of the Nantahala-Tapoco property used and useful in providing electric service to its retail customers in North Carolina is $18,749,000 (original cost of $36,951,000 less depreciation reserve of $18,202,000); that the reasonable replacement cost of said property is $57,795,000; that the fair value of Nantahala-Tapoco's utility plant used and useful in providing electric service to its retail customers in North Carolina giving a 40% weighting to original cost less depreciation and a 60% weighting to the trended original cost less depreciation is $42,177,000; that said fair value includes a reasonable fair value increment of $23,428,000; that the reasonable allowance for working capital net of customer deposits is $925,000 ($1,113,000 - $188,000); and that the total reasonable fair value of Nantahala-Tapoco's property in service to its North Carolina retail customers is $43,102,000.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 12 AND 13

With respect to the test year level of operating revenue and operating revenue deductions the differences between the parties arise, in all material respects, as a result of the use of different

allocation techniques and as a result of Intervenor witness Solomon having excluded certain revenue and revenue-related expense adjustments of Company witness Vander Veen from the total combined Nantahala-Tapoco system operations.

The Commission has previously adopted the allocation techniques employed by the Intervenors for use herein. The revenue and revenue-related expense adjustments of witness Vander Veen excluded from witness Solomon's total system cost-of-service determination relate to non-Fontana agreement power purchased from TVA to serve the Alcoa load. As a result of the methodology employed in the assignment or allocation of costs proposed by Intervenor witnesses Springs and Solomon and that adopted by the Commission, neither inclusion or exclusion of said revenue and expense adjustments would have any effect upon the combined system's North Carolina operations.

The Commission, therefore, concludes, based upon the entire evidence of record, that the test year level of operating revenue of $11,067,00 and operating revenue deductions including taxes and interest on customer deposits of $8,322,000 are proper for use herein. Said levels of revenue and operating revenue deductions are those proposed by the Intervenors with one minor exception. The exception being that the level of income tax expense proposed by witness Solomon has been adjusted to reflect the impact of a slightly different level of interest expense assigned by the Commission to the Nantahala-Tapoco system's North Carolina retail operations (see Schedule II contained herein).

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 14, 15, 16, AND 17

The capital structure, the embedded cost of debt, and the proper equity and overall rates of return for Nantahala were established in the June 14, 1977, Commission Order entered in this

case. As much as possible, Tapoco and the Nantahala-Tapoco unified system should be similarly treated in this remanded hearing although certain adjustments are necessary.

Prior to the original filing in this case, Nantahala had been permitted, in Docket No. E-13, Sub 26, to restate depreciation of its assets from accelerated depreciation actually taken to normal straight-line depreciation. At that time the Commission ordered that approximately 48% of the restated depreciation be treated as deferred income taxes. The remaining balance of approximately 52% was credited to capital as retained earnings.

In the current case, Tapoco seeks to restate its accelerated depreciation to normal straight-line depreciation as was allowed for Nantahala in Docket No. E-13, Sub 26. This difference between the accelerated and straight-line depreciation technique is $15,705,393. The Intervenors do not object to the restatement of depreciation provided it is handled similarly to Nantahala's. Accordingly, the Intervenors contend that 48% of the $15,705,393, which is $7,538,589, should be credited to deferred income taxes and treated as cost-free capital (Solomon prefiled testimony, p. 7).

The Companies contend, if they are required to reflect restatement of the depreciation reserve account in the manner proposed by the Intervenors, that said restatement will result in an overrecovery of costs from Alcoa. Further, the Companies argue that such credit has been made (Vol. 20, tr. p. 19). Intervenors vigorously disagree with this assertion. Reference to Companies' Ex. RDB-R4, pp. 4–5 of 5, shows that the only cost-free capital which they have proposed for the combined Companies is $4,753,925 which is identified as Nantahala's cost-free capital (See Intervenor's Ex. JBS-1, p. 1 of 3).

The Commission, after having very carefully considered the entire evidence of record with respect hereto, concludes that the level of deferred income taxes proposed by the Intervenors of approximately $12,292,000 is proper for use herein.

With respect to the proper level of debt and equity capitalization for Tapoco, the Intervenors contend that such capitalization should be based upon the industry norm. More specifically, the Intervenors contend that the average capital component ratios of a group of 100 electric utilities actually maintained during the period 1975–1979, as compiled by the First Boston Corporation, are proper for use herein. The Companies disagree with the Intervenors, contending that the utilities included in the First Boston survey are in no way financially analogous to Tapoco. The Commission agrees with the Companies.

The Commission, therefore, concludes that the reasonable original cost capital structure for use herein is as follows:

Item	Percent
Debt	40.05
Common equity	37.00
Cost-free	22.95
Total	100.00

and when the fair value increment is added, the reasonable fair value capital structure becomes:

Item	Percent
Debt	18.28
Common equity	71.24
Cost-free	10.48
Total	100.00

As previously stated, the Commission in its Order of June 14, 1977, found and concluded, for reasons stated therein, that a return of 4.20% on the fair value of Nantahala's investment in service to its North Carolina retail customers was just and reasonable and that rates should be set so as to allow the Company a reasonable opportunity to earn said rate of return. The Commission hereby reaffirms its finding and conclusion with respect thereto.

In passing, the Commission observes that, as a result of its actions herein, the rate of return the Company has been afforded an opportunity to earn on its original cost equity is far greater than that approved in the Commission Order of July 14, 1977.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 17, 18 AND 19

Based upon the findings of fact set forth herein above, the Commission concludes that the approximate annual level of revenues which Nantahala should be authorized to collect through rates charged for its sales of service is $9,032,000; that the rates and charges of Nantahala, based upon the adjusted test year level of operations, under rates approved by Commission Order of June 14, 1977, are excessive to the extent that said rates produce a level of revenue which is $2,035,000 ($11,067,000—$9,032,000) greater than the Applicant's revenue requirement (cost of service); that Nantahala should be required to reduce said rates and charges in a manner so as to achieve an annual gross revenue reduction of approximately $2,035,000, based upon the adjusted test year level of operations; and, that Nantahala should be required to refund to its North Carolina retail customers all revenue collected under the rates approved by Commission Order issued June 14, 1977, to the extent that said rates produced revenue in excess of the rates approved herein. Said refund shall include revenues collected under the Company's base rate structure as well as through operation of the Purchased Power Adjustment Clause plus interest computed and compounded at the legal annual rate. The methodology to be used in the determination of the level of excess revenues collected under the Purchased Power Adjustment Clause will be discussed subsequently.

The following charts summarize the gross revenues and the rates of return which the Company should have a reasonable opportunity to achieve, based upon the level of revenues approved herein. Such charts, illustrating the Company's gross revenue requirements, incorporate the findings, adjustments, and conclusions herein made by the Commission.

SCHEDULE I

NANTAHALA-TAPOCO COMBINED SYSTEM
NORTH CAROLINA RETAIL OPERATIONS
STATEMENT OF OPERATING INCOME, RATE BASE AND RATE OF RETURN
TWELVE MONTHS ENDED DECEMBER 31, 1975
(000'S OMITTED)

Operating Income

Line No.	Item (a)	Present Rates (b)	Decrease Required (c)	Approved Rates (d)
1.	OPERATING REVENUES	$11,067	$2,035	$9,032
2.	OPERATING REVENUE DEDUCTIONS:			
3.	Purchased power	423	—	423
4.	Operation and maintenance	3,612	—	3,612
5.	Depreciation and amortization	1,133	—	1,133
6.	Taxes—other than income	1,004	122	882
7.	Taxes—Federal and State income	2,142	978	1,164
8.	Interest on customer deposits	8	—	8
9.	Total deductions	8,322	1,100	7,222
10.	OPERATING INCOME FOR RETURN	$ 2,745	$ 935	$1,810

Rate Base and Rate of Return

Line No.	Item (a)	Amount (b)
1.	ORIGINAL COST NET INVESTMENT:	
2.	Electric plant in service	$36,951
3.	Less: Accumulated depreciation	18,202
4.	Net plant in service	18,749
5.	Plus: Allowance for working capital	1,113
6.	Less: Customer deposits	188
7.	TOTAL ORIGINAL COST NET INVESTMENT	$19,674
8.	FAIR VALUE RATE BASE	$43,102
9.	FAIR VALUE RATE OF RETURN:	
10.	—Present rates	6.37%
11.	—Approved rates	4.20%

SCHEDULE II

NANTAHALA-TAPOCO COMBINED SYSTEM
NORTH CAROLINA RETAIL OPERATIONS
STATEMENT OF RETURN UNDER PRESENT AND APPROVED RATES
TWELVE MONTHS ENDED DECEMBER 31, 1975
(000's OMITTED)

PRESENT RATES
FAIR VALUE RATE BASE

Line No.	Capitalization (a)	Fair Value Rate Base (b)	Ratio (%) (c)	Cost Rate (%) (d)	Weighted Rate (%) (e)	Operating Income (f)
1.	Debt	$ 7,880	18.28	7.56	1.38	$ 596
2.	Equity[1]	30,707	71.24	7.00	4.99	2,149
3.	Cost-free	4,515	10.48	—	—	—
4.	Total	$43,102	100.00	—	6.37	2.745

APPROVED RATES
FAIR VALUE RATE BASE

Line No.	Capitalization (a)	Fair Value Rate Base (b)	Ratio (%) (c)	Cost Rate (%) (d)	Weighted Rate (%) (e)	Operating Income (f)
1.	Debt	$ 7,880	18.28	7.56	1.38	$ 596
2.	Equity[1]	30,707	71.24	3.95	2.82	1,214
3.	Cost-free	4,515	10.48	—	—	—
4.	Total	$43,102	100.00	—	4.20	1.810

[1]Original cost equity	$ 7,279
Fair value increment	23,428
Fair value equity	$30,707

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 20

The Commission has previously concluded that the reasonable test year level of operating revenue deductions applicable to the Applicant's North Carolina retail operations should include purchased power costs in the amount of $423,000.

Stated alternatively, the Commission has concluded that approximately 24.60% of Nantahala's total demand related purchased power cost and approximately 24.51% of Nantahala's total energy related purchased power cost is properly assignable to its North Carolina retail operations. Further, it is observed that the Commission in its decision on remand has included in the Applicant's North Carolina retail operations only 24.56% ($423,000/$1,722,000) of the cost of purchased power that was initially included by the Commission in its Order of June 14, 1977. Nantahala's Purchased Power Adjustment Clause allows the Company to recover virtually all of any increase in the cost of purchased power incurred over and above that included in its base rates. The Company under rates approved by Commission Order of June 14, 1977, has recovered, in all material respects, 100% of the increased cost of purchased power related to the level of purchased power included in the Company base rates. As previously stated, the Commission has now determined that only 24.56% or $423,000 of the purchased power cost of $1,722,000 initially included in the Applicant's cost of service is properly includable therein. Therefore, in the interest of fairness and equity, the Commission is compelled to find and conclude that to the extent the Applicant has recovered from its North Carolina retail customers via its Purchased Power Adjustment Clause increases in the cost of purchased power exceeding 24.60% of total Company (Nantahala) demand related increases and 24.51% of total Company (Nantahala) energy related increases, said recoveries are unjust and unreasonable and should be refunded to the Applicants' North Carolina retail customers. Further, the Commission con-

cludes that the purchased power base unit cost and the Purchased Power Adjustment Clause as they presently exist must be modified so as to conform with the Commission decision with respect thereto. More specifically, such clause should be formulated in a manner so as to permit recovery of only that portion of the increased cost of purchased power attributable to the Applicant's North Carolina retail operations, i.e., 24.56% of total Company demand related increases and 24.51% of total Company energy related increases.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 21

In its decision the Supreme Court stated as follows:

> "... we believe that essential fairness to all the parties is best served by allowing the increased rates to remain in effect, conditioned upon Nantahala's guarantee that it will in the future refund to its customers any overcharges should the new rates ultimately be determined excessive. Accordingly, we reverse the Court of Appeals' setting aside of the order of 14 June 1977 and direct the Commission to obtain adequate assurances of Nantahala's willingness and continued ability to refund such overcharges as may ultimately result from imposition of the 1977 rate schedule." 299 N.C., at 444.

In its Order of July 29, 1980, the Commission found and concluded that the rates approved for Nantahala in the Order of June 14, 1977, should be allowed to remain in effect pending further proceedings in this docket on condition that Nantahala file with the Commission an Undertaking to Refund, in a manner prescribed by the Commission, the amount, if any, found to be owing to its customers should the rates approved by the Order of June 14, 1977, be ultimately determined to be excessive after hearing on the remand from the Supreme Court.

On September 22, 1980, an Undertaking to Refund was filed by Nantahala.

On March 11, 1981, the Intervenors filed Motion to Require Alcoa and Tapoco to Join in the Execution of Nantahala's Undertaking to Refund or to Guarantee Nantahala's Continuing Financial Viability. In its Motion the Intervenors alleged that "[a]s a result of the operation by Alcoa of Nantahala and Tapoco as a single electric system, Nantahala has been and continues to be injured with 'concealed benefits' flowing from it to Alcoa and Tapoco." The Motion further alleged:

> "7. While the Nantahala ratepayers will be benefitted by the roll-in of Tapoco in rate making, the roll-in will not stop the flow of concealed benefits from Nantahala to Alcoa and Tapoco. This situation will be greatly exacerbated if, as Nantahala has several times predicted, rate refunds and lower rates resulting from a determination by this Commission favorable to intervenors would threaten Nantahala with bankruptcy. Alcoa should not be permitted to allow or cause Nantahala to go bankrupt when Alcoa itself is a party public utility in this proceeding and, through piercing of the corporate veil, responsible to the consuming public as such. Accordingly, Alcoa and Tapoco should be made to share in the "Undertaking To Refund," should a refund be ordered, for the protection of the financial soundness of Nantahala, or, in the alternative, should be required to guarantee Nantahala's ability to refund without injuring its viability as a public utility serving a public load in North Carolina."

On March 23, 1981, Alcoa and Tapoco filed its Response to the Intervenors' Motion. In their Motion Alcoa and Tapoco argued that the Intervenors' Motion was procedurally defective in that the relief sought was beyond the scope of the Supreme Court's remand, was in the nature of an untimely petition for reconsideration of the Commission's decision regarding Nantahala's undertaking, and was in the nature of a complaint and therefore beyond the scope of this proceeding. Alcoa and Tapoco also alleged that the relief sought by the Intervenors was beyond the Commission's jurisdiction over public utilities. Alcoa and Tapoco asked that the Intervenors' Motion be denied.

In this Order the Commision has found that Alcoa and Tapoco are public utilities; that Nantahala and Tapoco are wholly owned subsidiaries of Alcoa; that the Nantahala and Tapoco electric facilities constitute a single, integrated electric system and are operated by TVA as a coordinated part of the TVA system. The Commission has further found that for purposes of setting rates in this proceeding the Nantahala and Tapoco systems should be treated as one entity. Further, the Commission has found that the New Fontana Agreement, executed by TVA, Alcoa, Nantahala, and Tapoco, and the resultant 1971 Apportionment Agreement between Tapoco and Nantahala, have resulted in substantial benefits to Alcoa and significant detriment to the customers of Nantahala. Finally, the Commission has found that Alcoa has so dominated certain transactions and agreements affecting its wholly owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina.

The evidence in this proceeding discloses the inequities to Nantahala that arise out of both the New Fontana Agreement (NFA) and the 1971 Tapoco-Nantahala Apportionment Agreement. This evidence is fully described in Evidence and Conclusions for Findings of Fact Nos. 6 and 7. The detriment to Nantahala arising out of the 1971 Apportionment Agreement is summarized on page 19.

Moreover, the evidence in this proceeding, as fully described in Evidence and Conclusions for Findings of Fact Nos. 6 and 7, clearly and unambiguously demonstrates that the NFA was tailored to meet Alcoa's aluminum production needs with minimal consideration of Nantahala's public service needs in Western North Carolina. The Commission has noted elsewhere that Nantahala, while obligated under the original Fontana Agreement, was not a signatory thereto. The original Fontana Agreement still conveys significant benefits to Alcoa. Although Nantahala was a signatory to the New Fontana Agreement, it did

not participate in the negotiations of that agreement. Alcoa's dominance over its wholly owned subsidiaries Nantahala and Tapoco during the course of the New Fontana negotiations has resulted in substantial benefits to Alcoa and significant detriment to the customers of Nantahala. Tapoco is the conduit through which these benefits to Alcoa have flowed. Mr. Springs testified:

> "The 1963 Apportionment Contract shows on its face that the New Fontana Agreement was never intended as a 20-year power supply for NP&L public load. It appears that NP&L's officers and consultants were primarily concerned with the effect of the Agreement on the ongoing rate case and transfer cases before the NCUC and not with the interest of NP&L ratepayers over the 20-year period of Agreement."

The Commission must conclude that Alcoa has so dominated these transactions and agreements affecting its wholly owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina. Alcoa's domination of Nantahala in these transactions has resulted in Nantahala's collecting, through its base rates, excess revenue from its customers in the amount of approximately $2,035,000 a year since June 14, 1977. Moreover, this inequity is further magnified by the fact that Nantahala has collected significantly additional excess revenues through operation of its Purchased Power Adjustment Clause. Therefore, this Commission is compelled to order that, to the extent Nantahala is financially unable to make the revenue refunds required by this Order, Alcoa shall refund all or any portion of the aforementioned revenue refunds that Nantahala is financially unable to make.

IT IS, THEREFORE, ORDERED as follows:

1. That the approximate annual level of revenues which Nantahala is hereby authorized to collect through rates charged for its sales of service, based upon the adjusted test year level of operations, is $9,032,000.

2. That the rates and charges of Nantahala, based upon the adjusted test year level of operations, under rates approved by Commission Order of June 14, 1977, are excessive to the extent that said rates produce a level of revenue which is $2,035,000 ($11,067,000—$9,032,000) greater than the Applicant's revenue requirement (cost of service). Thus, Nantahala is hereby ordered to reduce said rates and charges by a uniform percentage across all rate schedules and charges in a manner so as to achieve an annual gross revenue reduction of approximately $2,035,000, based upon the adjusted test year level of operations.

3. That Nantahala is hereby ordered to refund to its North Carolina retail customers all revenue collected under the rates approved by Commission Order issued June 14, 1977, to the extent that said rates produced revenue in excess of the level of rates approved herein. Said refund shall include excess revenues collected under the Company's base rate structure as well as through operation of the Purchased Power Adjustment Clause calculated in a manner consistent with the findings and conclusions set forth herein plus interest computed and compounded at the legal annual rate.

4. That Nantahala shall file for Commission approval within 10 working days of the issuance date of this Order rates designed in accordance with the foregoing Ordering Paragraphs. Such rates shall include a Purchased Power Adjustment Clause formulated in a manner consistent with the Commission's findings and conclusions as set forth under Evidence and Conclusions for finding of Fact No. 20.

5. That Nantahala shall file for Commission approval within 30 days from the issuance date of this Order its plan for making the refunds as required herein. Further, Nantahala, at such time, shall file 10 copies of its calculation of the total amount of refund due including 10 copies of all detailed work papers associated therewith.

6. That, to the extent Nantahala is financially unable to make the revenue refunds required under Ordering Paragraph No. 3 above, Alcoa shall refund all or any portion of the aforementioned revenue refunds that Nantahala is financially unable to make.

7. That, except to the extent the Commission Order of June 14, 1977, is inconsistent with the findings and conclusions as set forth herein, said Order is hereby reaffirmed.

ISSUED BY ORDER OF THE COMMISSION.

This the 2nd day of September 1981.

NORTH CAROLINA
UTILITIES COMMISSION

Sandra J. Webster, Chief Clerk

(SEAL)

[THIS PAGE INTENTIONALLY LEFT BLANK]

APPENDIX D

Opinion Of The North Carolina Utilities Commission, dated January 28, 1982

State of North Carolina
Utilities Commission
Raleigh

DOCKET NO. E-13, SUB 29

BEFORE THE
NORTH CAROLINA UTILITIES COMMISSION

In the Matter of

Application of Nantahala Power and Light Company for Authority to Adjust and Increase Its Electric Rates and Charges	FINAL ORDER OVERRULING EXCEPTIONS AND GIVING SUPPLEMENTARY CONCLUSIONS

BY THE COMMISSION: On September 2, 1981, a three member panel of the Commission issued an order in this docket which reduced rates and required refunds.

On October 19, 1981, Nantahala Power and Light Company (Nantahala) filed its Exceptions to and Notice of Appeal from the Panel's Order. Nantahala also filed Motion to Rescind, Alter or Amend Order and for Oral Argument and Further Hearings on Exceptions, and a brief in support of its exceptions.

On October 19, 1981, the Aluminum Company of America ("Alcoa") and Tapoco, Inc. ("Tapoco"), Respondents herein, also filed joint Exceptions to and Notice of Appeal from the Order of September 2, 1981. Alcoa and Tapoco also moved for reconsideration of the Panel's Order in light of their Exceptions and requested an opportunity to present oral argument on their exceptions before the full Commission. Tapoco and Alcoa also filed a brief in support of their Exceptions.

On October 26, 1981, the Intervenors filed their Initial Response to the Applicant and the Respondents' several exceptions, notices of appeal, motions, and briefs and asked that they be denied, and in the alternative prayed that if the matters should be set for further consideration by the full Commission, that they be permitted an additional 30 days to file an additional response.

By Order issued on October 28, 1981, the exceptions of Applicant and the Respondents were scheduled for oral argument before the full Commission pursuant to G.S. 62-90(c) on December 7, 1981, and the Intervenors were permitted to file an additional response. On November 30, 1981, the Intervenors filed their joint Brief in Opposition to Exceptions.

On December 7, 1981, oral argument was held before the full Commission on the Exceptions of the Applicant and the Respondents. All parties were present and represented by counsel. On December 7, 1981, the Respondents, Alcoa and Tapoco, filed a Reply Brief to the Intervenors' Joint Brief, and during oral argument requested that this brief be accepted for consideration by the Commission. During the course of the oral argument, the parties addressed questions of federal law raised for the first time in this proceeding in the Respondents' Exceptions and Briefs filed in conjunction with their Notice of Appeal. During the argument, the Intervenors requested permission to further address these federal questions in writing after the oral argument. The Commission took under advisement the request to accept the Reply Brief and the request for permission to address the federal questions.

Subsequently, on December 16, 1981, the Commission entered an Order which accepted for consideration the Reply Brief and permitted all parties to file within 30 days "comments or memoranda or proposed findings with respect to the federal questions raised by the Respondents in their Brief and Exceptions to the Order of September 2, 1981." Nantahala and the Respondents have also filed Exceptions to this Order.

On January 15, 1982, the Intervenors filed with the Commission a proposed order styled "Intervenors' Proposed Order Entitled: Final Order Overruling Exceptions and Giving Supplemental Conclusions." On January 15, 1982, the Applicant, Nantahala, also filed its Response addressed to the federal questions. The Respondents, Alcoa and Tapoco, did not file. Respondents did, however, file on January 20, 1981, a Motion requesting the Commission to either reject the Intervenors' Proposed Order for the reason that it addressed issues other than federal questions, or in the alternative, to allow the Respondents an extension of time to file a counter proposed order.

Based upon a careful consideration of all the foregoing, the Commission concludes as follows:

I. The Intervenors' Proposed Order should be and has been accepted for consideration only insofar as it addresses "the federal questions raised by the Respondents." The Commission has accepted for consideration only the following portions of the Proposed Order:

- *Page 3*, Paragraphs III and IV

Page 4, Paragraphs V and VII

Page 4, The last Paragraph as it continues through line 16 on Page 5

Page 7, Line 16 and continuing through Page 13, line 15

Page 14, Paragraph B

The remaining portions of the Intervenors' Proposed Order are unresponsive in that they present arguments of other issues and have not been considered by the Commission. The Commission concludes that since it has not considered portions of Intervenors' Proposed Order which expands beyond the federal questions, the Applicants are not entitled to file a further proposed order which would encompass non-federal questions. Respondents have

previously chosen not to address the federal questions within the 30 days allowed except to the extent they have attempted to reserve them.

II. The Commission has carefully reconsidered each of the 21 separate Findings of Fact and the Evidence and Conclusions as to each Finding in the Panel's Order of September 2, 1981, in light of the Applicant's and the Respondents' exceptions thereto. The Commission concludes that each of the findings is fully supported by the evidence of record in this proceeding, and the Panel's conclusions of law are well reasoned and supported by the findings and the evidence. The Commission concludes that the Panel's Order should be affirmed.

In addition to the foregoing conclusions, the Commission makes the following supplemental conclusions relating to the federal questions raised by Respondents' Exceptions and Briefs:

III. The Applicant and Respondents may not reserve so-called "federal questions" for decision by another forum.

Both the Applicant and the Respondents attempted to expressly reserve certain so-called "federal questions" for submission to a federal tribunal. The Commission hereby rejects such attempts.

We observe that each of these "federal questions" inherently arose from the nature of the remand by the North Carolina Supreme Court, from the pleadings of all parties and from the total record of evidence placed before the Panel in this proceeding. Under these circumstances, the Commission does not believe that the doctrine of abstention as enunciated in the cases of *England* v. *Louisiana State Board*, 375 U.S. 411, 84 S. Ct. 461, 11 h. Ed. 2d 440 (1964) and *Government & Civic Employees* v. *Windsor*, 353 U.S. 364, 77S. Ct. 838, 1 L. Ed 2d 894 (1957) is either available or applicable to the so-called "federal questions" argued before us by Applicant and Respondents. In addition, the doctrine appears

to be available only when there is a prior or superior action pending in the federal court, which action is held in abeyance pending the disposition of certain non-federal questions in the state courts. Those circumstances do not exist here. This action has been proceeding in the state tribunals since 1975 (on remand since 1980) without the existence of any prior or superior federal cause of action.

In addition, given the great length of time over which this proceeding has already been contested, we firmly believe that it is incumbent upon this Commission to decide all questions over which this Commission has jurisdiction and to defer to others only questions over which this Commission has no jurisdiction. We conclude that the Commission has ample jurisdiction to hear and decide all issues raised in the remand, the pleadings, the evidence presented and the exception to the September 2, 1981 Order. Such questions have been heretofore or are herein decided.

IV. The Panel's Order is not precluded by exclusive federal regulation of interstate hydro power licensing, generation, sales and exchange operations; federal regulation of headwater benefits; or powers awarded to TVA by federal law.

A. *Part II of the Federal Power Act.*

1. The roll-in does not conflict with the preemptive jurisdiction of FERC to fix and regulate interstate wholesale electric rates.

The current docket is involved exclusively with the setting of retail rates for Nantahala. The case *does not involve* any attempt by this Commission to fix, establish, amend, alter, invalidate or modify rates or agreements approved by FERC. Not a single word of any of the contracts, apportionments or agreements as between TVA-Nantahala, TVA-Tapoco, Nantahala-Tapoco or Tapoco-Alcoa has been changed nor were any of the rates set by those agreements changed.

Indeed, the only thing which this Commission has done is to set retail rates for Nantahala pursuant to the remand of the North Carolina Supreme Court in the *Edmisten* case, 299 N.C. 432, 263 S.E. 2d 583 (1980). Having determined that the use of an appropriately performed roll-in of Nantahala and Tapoco (which is a question of *Fact*) would be beneficial to Nantahala's customers, the Panel concluded that rates based upon such roll-in should be placed into effect. With this conclusion the full Commission concurs.

It is entirely appropriate for a state commission to regulate retail rates. Congress has clearly indicated a desire to draw a bright line between federal regulation of interstate or wholesale rates and state regulation of intrastate or retail rates. *FPC* v. *So. California Edison,* 376 U.S. 205, 84 S. Ct. 644, 11 L.Ed 2d 638 (1944).

We conclude that the use of the roll-in as contained in the September 2 Order was in all respects proper, was consistent with the remand of the North Carolina Supreme Court and was not in conflict with FERC's jurisdiction over the various wholesale contracts, agreements and rates, either in law or in fact.

2. The September 2 Order does not intrude upon the authority vested in FERC by Part II of the Federal Power Act by failing to accept the costs of filed rates.

Several of the Agreements and contracts as between and among Nantahala, Tapoco, Alcoa and TVA constitute "filed rates" with FERC. What Applicant and Respondents apparently fail to realize is that no reasonable cost incurred by either Nantahala or Tapoco has been omitted from consideration. Every reasonable and proper cost was included in the data utilized and relied upon by the Panel in calculating the combined Nantahala-Tapoco cost of service on a roll-in basis.

The reason rates were lowered was not from a failure by the Panel to recognize legitimate costs, but because, as we have noted, the roll-in technique combines the lower cost of Tapoco production with the higher cost of Nantahala production. Since Nantahala and its customers are responsible for only about 24% of the combined Nantahala-Tapoco costs, Nantahala benefits from the roll-in and its rates can be lowered.

The costs of the Alcoa-TVA Supplemental Purchase Power Agreement were not included since these do not constitute a filed rate applicable to the Nantahala-Tapoco combined system. They are a separate matter entirely between TVA and one of its large industrial customers. Even if such costs had been included, they could properly have been attributed only to Alcoa and hence could not change the Commission's determination of the proper rates and charges for Nantahala.

3. The Panel's Order did not intrude upon the federal domain by disrupting the fabric of rates charged to Alcoa and Tapoco and TVA.

As noted, the September 2 Order does not infringe in any way upon the TVA-Alcoa Supplemental Purchase Power Agreement. Neither did such Order attempt, much less accomplish, any change whatsoever in rates charged by Tapoco to Alcoa. The Fontana Agreements, Apportionment Agreement and Alcoa Supplemental Power Agreement remain in effect exactly as before.

Again, at the risk of repetition, the roll-in is not a technique for disrupting the fabric of fixed economical relationships under filed FERC rates. It is, instead, merely a court approved method of combining financial data and allocating costs of the two companies, Nantahala and Tapoco, which have been found to constitute a single, integrated public utility system.

B. *Part I of the Federal Power Act*

The Commission does not agree with Applicant and Respondents that, by federal license, all of the hydroelectric production

from (or the economic benefit of) the four Tapoco dams are reserved exclusively for Alcoa. If the production were reserved exclusively for Alcoa, there could be no New Fontana Agreement (by which TVA exclusively generates and dispatches the power output of these dams). This output does not currently flow exclusively to Alcoa.

When Tapoco acquired ownership of two of these dams, Cheoah and Santeetlah, they were encumbered with an obligation to serve the public in North Carolina. In conjunction with the transfer, Tapoco was issued a certificate of public convenience and necessity in North Carolina, which imposes all the duties and responsibilities, including the duty to serve the public, of a public utility on Tapoco. Federal law requires, before a hydro license is issued, that the applicant submit evidence of compliance with state law concerning the operation of a public utility enterprise. The issuance of a federal license to construct and operate a hydroelectric project is a far cry from an edict by the federal licensing agency providing for the permanent allocation of the entire electrical energy output (or economic benefit) from the project. To the extent that the federal licenses for Tapoco's dams speak toward dedication of the electric energy, such dedication would of necessity include the using and consuming public of North Carolina.

In any event, the roll-in itself does not address the proposition (as we have earlier noted) of diverting Tapoco's actual energy production to the North Carolina public load. All the roll-in has accomplished is to allocate the costs of production of the Nantahala-Tapoco combined system, as between the North Carolina retail public load and the Alcoa manufacturing load. This allocation is no different from other allocations routinely performed by the Commission (e.g. for Duke, CP&L or Vepco) to distinguish between the North Carolina retail load and other loads over which the Commission has no jurisdiction.

C. *Regulation of Headwater Benefits.*

Again the Applicant and Respondents appear to believe, erroneously, that the Commission's September 2 Order in some way confers upstream benefits to Nantahala which are precluded by federal law and regulation. To the contrary, the so-called upstream benefits are a part of the Panel's overall discussion of concealed benefits accruing to Alcoa from the Fontana Agreement, New Fontana Agreement and the 1971 Apportionment Agreement. The sole reason for the entire discussion was not to provide a finite recovery to Nantahala of upstream benefits, but instead was required (a) to establish a foundation for the Panel's use of the roll-in methodology recommended by Intervenors as opposed to that recommended by the Applicant and Respondents, and (b) to show Alcoa's dominance over Nantahala and Tapoco which resulted in concealed benefits accruing to Alcoa.

D. *The Commission's September 2 Order does not interfere with the proper exercise of federal oversight by TVA.*

We reject the argument that the Panel's Order in any way contravenes the power of TVA to insure that the resale of power sold by TVA is reasonable and fair. The Commission's Order in no way challenges any rates set by or arguments entered into by TVA.

The authority of TVA cannot rationally be construed so as to extend to TVA the power to usurp proper rate setting authority now being exercised by FERC or by state commission. There is no evidence that TVA has ever done anything but accept retail/wholesale rates charged by its vendees, particularly when such rates were *fixed* and *established* by FERC or by a state commission.

We believe that unless and until this Commission enters an Order, which has not been done here, which injures or interferes with TVA's rates or operations, TVA not only will but must

accept such regulation of North Carolina retail rates by this Commission.

V. The Panel's September 2 Order does not impose unreasonable burden on interstate commerce.

The Commission does not view that the commerce clause of the United States Constitution has any more relevance to this proceeding than to a Duke, CP&L or Vepco retail rate proceeding. We repeat that the roll-in, as employed by the Panel, does no more than establish the overall cost of operation of the single, unified Nantahala-Tapoco system and allocate the proper portion of those costs to North Carolina retail customers for the purpose of fixing just and reasonable rates for Nantahala.

Even if it be assumed, *arguenda,* that the commerce clause is applicable to the current case, we do not believe that there has been any violation. The rule is that, where a local statute regulates evenhandedly to effectuate a legitimate local interest, and its effects on interstate commerce are only incidental, the local statute will be upheld unless the burden on interstate commerce is clearly excessive in relation to the local benefit.

The setting of retail electric rates for Nantahala's customers is clearly a legitimate North Carolina interest with a significant impact in this State. Since not a word of the contracts or agreements properly within the federal sphere has been changed, we do not believe that there is any impact on interstate commerce. Even if there is, such impact is clearly *de minimis* when compared to the local interest.

The public utility system organized, controlled and manipulated for so many years by Alcoa to serve its own manufacturing interests has now developed to such a degree that the local North Carolina interest demands that a proper allocation methodology be used so as to fairly distribute service costs between the North

Carolina retail ratepayers and Alcoa's manfacturing load. The roll-in technique adopted by the Panel accomplishes this goal without undue imposition on interstate commerce.

IT IS THEREFORE, ORDERED:

1. That the Respondents' Motion for an extension of time to file a counter "Proposed Order" is denied.

2. That the Commission's Order of September 2, 1981, as supplemented herein be, and the same is hereby, affirmed and sustained in all respects and is further adopted by the Full Commission as its Order.

3. That the exceptions, and each of them as filed by Nantahala, Tapoco and Alcoa be, and the same hereby are, overruled, denied and dismissed.

4. That the Stay Order issued in September 1981, pending ruling on the exceptions to the Panel's Order is vacated.

ISSUED BY ORDER OF THE COMMISSION.

This the 28th day of January 1982.

NORTH CAROLINA
UTILITIES COMMISSION

Sandra J. Webster, Chief Clerk

(SEAL)

APPENDIX E

Excerpts From The Federal Power Act, 16 U.S.C. §§ 791a–828c

Section 4, 16 U.S.C. § 797:

General powers of Commission

The Commission is authorized and empowered—

* * *

(e) **Issue of licenses for construction, etc., of dams, conduits, reservoirs, etc.**

To issue licenses to citizens of the United States, or to any association of such citizens, or to any corporation organized under the laws of the United States or any State thereof, or to any State or municipality for the purpose of constructing, operating, and maintaining dams, water conduits, reservoirs, power houses, transmission lines, or other project works necessary or convenient for the development and improvement of navigation and for the development, transmission, and utilization of power across, along, from, or in any of the streams or other bodies of water over which Congress has jurisdiction under its authority to regulate commerce with foreign nations and among the several States, or upon any part of the public lands and reservations of the United States (including the Territories), or for the purpose of utilizing the surplus water or water power from any Government dam, except as herein provided: *Provided,* That licenses shall be issued within any reservation only after a finding by the Commission that the license will not interfere or be inconsistent with the purpose for which such reservation was created or acquired, and shall be subject to and contain such conditions as the Secretary of the department under whose supervision such reservation falls shall deem necessary for the adequate protection and utilization of such reservations: *Provided further,* That no license affecting the navigable capacity of any navigable waters of the United States shall be issued until the plans of the dam or other structures affecting the navigation have been approved by the Chief of Engineers and the Secretary of the Army. Whenever the contemplated improvement is, in the judgment of the Commission, desirable and justified in

the public interest for the purpose of improving or developing a waterway or waterways for the use or benefit of interstate or foreign commerce, a finding to that effect shall be made by the Commission and shall become a part of the records of the Commission: *Provided further,* That in case the Commission shall find that any Government dam may be advantageously used by the United States for public purposes in addition to navigation, no license therefor shall be issued until two years after it shall have reported to Congress the facts and conditions relating thereto, except that this provision shall not apply to any Government dam constructed prior to June 10, 1920: *And provided further,* That upon the filing of any application for a license which has not been preceded by a preliminary permit under subsection (f) of this section, notice shall be given and published as required by the proviso of said subsection.

* * *

Section 6, 16 U.S.C. § 799:

License; duration, conditions, revocation, alteration, or surrender

Licenses under this subchapter shall be issued for a period not exceeding fifty years. Each such license shall be conditioned upon acceptance by the licensee of all of the terms and conditions of this chapter and such further conditions, if any, as the Commission shall prescribe in conformity with this chapter, which said terms and conditions and the acceptance thereof shall be expressed in said license. Licenses may be revoked only for the reasons and in the manner prescribed under the provisions of this chapter, and may be altered or surrendered only upon mutual agreement between the licensee and the Commission after thirty days' public notice. Copies of all licenses issued under the provisions of this subchapter and calling for the payment of annual charges shall be deposited with the General Accounting Office, in compliance with section 20 of title 41.

Section 10, 16 U.S.C. § 803:

Conditions of license generally

All licenses issued under this subchapter shall be on the following conditions:

(a) Modification of plans, etc., to secure adaptability of project

That the project adopted, including the maps, plans, and specifications, shall be such as in the judgment of the Commission will be best adapted to a comprehensive plan for improving or developing a waterway or waterways for the use or benefit of interstate or foreign commerce, for the improvement and utilization of water-power development, and for other beneficial public uses, including recreational purposes; and if necessary in order to secure such plan the Commission shall have authority to require the modification of any project and of the plans and specifications of the project works before approval.

* * *

Section 201, 16 U.S.C. § 824:

Declaration of policy; application of subchapter

(a) Federal regulation of transmission and sale of electric energy

It is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III of this chapter and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States.

(b) Use or sale of electric energy in interstate commerce

(1) The provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce, but except as provided in paragraph (2) shall not apply to any other sale of electric energy or deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line. The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.

* * *

(c) Electric energy in interstate commerce

For the purpose of this subchapter, electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States.

(d) "Sale of electric energy at wholesale" defined

The term "sale of electric energy at wholesale" when used in this subchapter, means a sale of electric energy to any person for resale.

(e) "Public utility" defined

The term "public utility" when used in this subchapter and subchapter III of this chapter means any person who owns or operates facilities subject to the jurisdiction of the Commission under this subchapter (other than facilities subject to such jurisdiction solely by reason of section 824i, 824j, or 824k of this title).

* * *

Section 205, 16 U.S.C. § 824d:

Rates and charges; schedules; suspension of new rates; automatic adjustment clauses

(a) Just and reasonable rates

All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) Preference or advantage unlawful

No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Schedules

Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Notice required for rate changes

Unless the Commission otherwise orders, no change shall be made by any public utility in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after sixty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the sixty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Suspension of new rates; hearings; five month period

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint or upon its own initiative without complaint, at once, and, if it so orders, without answer or formal pleading by the public utility, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the public utility affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of such five months, the proposed change

of rate, charge, classification, or service shall go into effect at the end of such period, but in case of a proposed increased rate or charge, the Commission may by order require the interested public utility or public utilities to keep accurate account in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require such public utility or public utilities to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such increased rates or charges as by its decision shall be found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

(f) Review of automatic adjustment clauses and public utility practices; action by Commission; definition

(1) Not later than 2 years after November 9, 1978, and not less often than every 4 years thereafter, the Commission shall make a thorough review of automatic adjustment clauses in public utility rate schedules to examine—

(A) whether or not each such clause effectively provides incentives for efficient use of resources (including economical purchase and use of fuel and electric energy), and

(B) whether any such clause reflects any costs other than costs which are—

(i) subject to periodic fluctuations and

(ii) not susceptible to precise determinations in rate cases prior to the time such costs are incurred.

Such review may take place in individual rate proceedings or in generic or other separate proceedings applicable to one or more utilities.

(2) Not less frequently than every 2 years, in rate proceedings or in generic or other separate proceedings, the Commission shall review, with respect to each public utility, practices under any automatic adjustment clauses of such utility to insure efficient use of resources (including economical purchase and use of fuel and electric energy) under such clauses.

(3) The Commission may, on its own motion or upon complaint, after an opportunity for an evidentiary hearing, order a public utility to—

(A) modify the terms and provisions of any automatic adjustment clause, or

(B) cease any practice in connection with the clause,

if such clause or practice does not result in the economical purchase and use of fuel, electric energy, or other items, the cost of which is included in any rate schedule under an automatic adjustment clause.

(4) As used in this subsection, the term "automatic adjustment clause" means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include any rate which takes effect subject to refund and subject to a later determination of the appropriate amount of such rate.

Section 206, 16 U.S.C. § 824e:

Power of Commission to fix rates and charges; determination of cost of production or transmission

(a) Unjust or preferential rates, etc.

Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any

public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affected such rate, charge, or classification is injust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

(b) Investigation of costs

The Commission upon its own motion, or upon the request of any State commission whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transmission of electric energy by means of facilities under the jurisdiction of the Commission in cases where the Commission has no authority to establish a rate governing the sale of such energy.

Section 306, 16 U.S.C. § 825e:

Any person, State, municipality, or State commission complaining of anything done or omitted to be done by any licensee or public utility in contravention of the provisions of this chapter may apply to the Commission by petition which shall briefly state the facts, whereupon a statement of the complaint thus made shall be forwarded by the Commission to such licensee or public utility, who shall be called upon to satisfy the complaint or to answer the same in writing within a reasonable time to be specified by the Commission. If such licensee or public utility shall not satisfy the complaint within the time specified or there shall appear to be any reasonable ground for investigating such complaint, it shall be the duty of the Commission to investigate the matters complained of in such manner and by such means as it shall find proper.

APPENDIX F

Excerpts From The North Carolina Public Utilities Act, N.C. Gen. Stat. §§ 62-1, *et seq.*

§ 62-133. How rates fixed.

(a) In fixing the rates for any public utility subject to the provisions of this Chapter, other than motor carriers and certain water and sewer utilities, the Commission shall fix such rates as shall be fair both to the public utility and to the consumer.

(b) In fixing such rates, the Commission shall:

(1) Ascertain the reasonable original cost of the public utility's property used and useful, or to be used and useful within a reasonable time after the test period, in providing the service rendered to the public within this State, less than portion of the cost which has been consumed by previous use recovered by depreciation expense plus the reasonable original cost of investment in plant under construction (construction work in progress). In ascertaining the cost of the public utility's property, construction work in progress as of the effective date of this subsection shall be excluded until such plant comes into service but reasonable and prudent expenditures for construction work in progress after the effective date of this subsection may be included, to the extent the Commission considers such inclusion in the public interest and necessary to the financial stability of the utility in question, subject to the provisions of subparagraph (b)(5) of this section.

(2) Estimate such public utility's revenue under the present and proposed rates.

(3) Ascertain such public utility's reasonable operating expenses, including actual investment currently consumed through reasonable actual depreciation.

(4) Fix such rate of return on the cost of the property ascertained pursuant to subdivision (1) as will enable the public utility by sound management to produce a fair return for its shareholders, considering changing economic conditions and other factors, as they then exist, to maintain its facilities and services in accordance with the reasonable requirements of its customers in the territory covered by its franchise, and to compete in the market for capital funds on terms which

are reasonable and which are fair to its customers and to its existing investors.

(4a) Require each public utility to discontinue capitalization of the composite carrying cost of capital funds used to finance construction (allowance for funds) on the construction work in progress included in its rate based upon the effective date of the first and each subsequent general rate order issued with respect to it after the effective date of this subsection; allowance for funds may be capitalized with respect to expenditures for construction work in progress not included in the utility's property upon which the rates were fixed. In determining net operating income for return, the Commission shall not include any capitalized allowance for funds used during construction on the construction work in progress included in the utility's rate base.

(5) Fix such rates to be charged by the public utility as will earn in addition to reasonable operating expenses ascertained pursuant to subdivision (3) of this subsection the rate of return fixed pursuant to subdivisions (4) and (4a) on the cost of the public utility's property ascertained pursuant to subdivision (1).

(c) The original cost of the public utility's property, including its construction work in progress, shall be determined as of the end of the test period used in the hearing and the probable future revenues and expenses shall be based on the plant and equipment in operation at that time. The test period shall consist of 12 months' historical operating experience prior to the date the rates are proposed to become effective, but the Commission shall consider such relevant, material and competent evidence as may be offered by any party to the proceeding tending to show actual changes in costs, revenues or the cost of the public utility's property used and useful, or to be used and useful within a reasonable time after the test period, in providing the service rendered to the public within this State, including its construction work in progress, which is based upon circumstances and events occurring up to the time the hearing is closed.

(d) The Commission shall consider all other material facts of record that will enable it to determine what are reasonable and just rates.

(e) The fixing of a rate of return shall not bar the fixing of a different rate of return in a subsequent proceeding.

(f) Unless otherwise ordered by the Commission subsections (b), (c), and (d) shall not apply to rate changes of utilities engaged in the distribution of natural gas bought at wholesale by the utility for distribution to consumers to the extent such rate changes are occasioned by changes in the wholesale rate of such natural gas. The Commission may permit such rate changes to become effective simultaneously with the effective date of the change in the wholesale cost of such natural gas, or at such other time as the Commission may direct. This subsection shall not prohibit the Commission from investigating and changing unreasonable rates in accordance with the provisions of this Chapter. The public utility shall give such notice, which may include notice by publication, of the changes to interested parties as the Commission in its discretion may direct.

(g) Reserved.

(h) The Commission is not authorized to entertain applications filed on behalf of intrastate rail carriers to fix rates for a single commodity or to fix rates for groups of commodities which constitute less than a general rate increase.

APPENDIX G

Opinion Of FERC In *Tapoco, Inc.*, Docket No. ER81-19-000

Tapoco, Inc., Docket No. ER81-19-000

Order Declaring Jurisdiction, Accepting Agreement for Filing Subject to Outcome of Other Proceedings, Waiving Notice and Additional Filing Requirements, Granting Intervention, and Terminating Docket

(Issued December 2, 1980)

Before Commissioners: Charles B. Curtis, Chairman; Matthew Holden, Jr., George R. Hall and J. David Hughes.

On October 9, 1980, Tapoco, Inc. (Tapoco) tendered for filing, pursuant to section 35.12 of the Commission's regulations, an apportionment agreement with Nantahala Power and Light Company (NP&L) dated June 1, 1971,[1] which arose out of a December 27, 1962 agreement entitled the New Fontana Agreement (NFA).

The NFA, which is on file as Tapoco's Rate Schedule No. 3, provides for an energy-for-energy swap by Tapoco and NP&L, both subsidiaries of Alcoa, with the Tennessee Valley Authority (TVA). Under the NFA, the energy generated by Tapoco and NP&L is dispatched by and delivered to TVA which, in return, provides Tapoco and NP&L with a fixed annual entitlement of power to be delivered at specified points.

The apportionment agreement is an adjunct to the NFA, specifying the amounts of TVA energy to which NP&L and Tapoco are entitled. While the NFA has been on file with the Commission, the 1971 apportionment agreement has not. In consolidated Docket Nos. EL78-18 and EL78-828,[2] the Commission staff expressed the position that Commission regulations mandated the filing of the apportionment agreement on the grounds that

[1]Designated as Supplement No. 2 to Tapoco Rate Schedule FPC No. 3.

[2]Docket No. EL78-18 is a complaint proceeding initiated by the Town of Highlands, North Carolina. Docket No. ER76-828 is a proceeding instituted to consider proposed wholesale rates filed by NP&L.

it is a jurisdictional rate schedule and an integral portion of the NFA. Tapoco indicates in its transmittal letter that it is cognizant of the broad definition of "rate schedule" under the Federal Power Act as set forth in 35.2 of the regulations, and that it therefore has chosen not to contest the issue and has tendered the instant filing. However, Tapoco further states, somewhat inconsistently, that it is submitting the apportionment agreement under protest "because of the potential conflicting jurisdictional assertions by the Commission and the Tennessee Valley Authority."

Tapoco requests that the Commission find the agreement to be non-jurisdictional, asserting that no rates, charges or jurisdictional services are specified therein. Moreover, Tapoco requests waiver of any additional filing requirements contemplated by the Commission's regulations on the grounds that the agreement does not provide for any service to be rendered by Tapoco and that the terms and conditions of the instant submittal have been litigated in Docket Nos. ER76-828 and EL78-18.

Notice of the filing was issued on October 21, 1980, with comments, protests, or petitions to intervene due on or before November 10, 1980. The Town of Highlands, North Carolina, a wholesale customer of NP&L, filed a protest and petition to intervene on November 10, 1980, primarily aimed at preserving its position in Docket Nos. EL78-18 and ER76-828. Highlands indicates that the instant agreement has been the subject of extensive litigation and that relitigation in the instant docket should be avoided. Highlands requests that the agreement be accepted for filing, that a determination be made that the submittal is jurisdictional, that Tapoco be required to file data in support of the power allotments contained in the filing, and that the submittal be suspended for five months from the filing of such data.

Highlands states that its principal areas of concern are: (1) the assurance that any action taken with respect to the instant docket will not prejudice its position or right to refunds in Docket Nos.

EL78-18 and ER76-828; and (2) the preservation of Commission authority to order appropriate modifications to the instant agreement upon final disposition of Docket Nos. EL78-18 and ER76-828.

Discussion

The Commission notes that the apportionment agreement is an integral part of the NFA designed to implement the provisions of the NFA. As indicated above, the NFA is a jurisdictional rate schedule on file with the Commission. Accordingly, the Commission concludes that the apportionment agreement, as a contract relating to and affecting operation of a filed rate schedule, is itself a jurisdictional rate schedule which should appropriately be filed as a supplement to the NFA. We further observe, however, that the issue of the proper apportionment of TVA power between NP&L and Tapoco is a subject which has been fully litigated and is awaiting initial decision in Docket Nos. ER76-828 and EL78-18. Therefore, the Commission will declare the apportionment agreement to be jurisdictional, and will waive outstanding filing requirements and accept the agreement for filing to become effective on June 1, 1971, when service commenced under the agreement. While we shall terminate the instant docket, the apportionment question shall remain subject to the outcome of the proceedings in Docket Nos. ER76-828 and EL78-18. In addition, we shall require NP&L to submit an appropriate certificate of concurrence which will also become effective as of June 1, 1971, subject to the outcome of the prior dockets.[3]

We believe that this procedure will preserve the interests of all affected parties, while avoiding unnecessary duplication of litigation. With respect to the apportionment issue, NP&L's wholesale customers will be protected in the event than any change is required in the allocation of costs between Tapoco and NP&L by

[3]NP&L has indicated that it challenges the jurisdictionality of the NFA, but that it will comply with applicable Commission directives.

means of the refund provision as stipulated in Docket Nos. EL78-18, ER76-828, and ER80-574.[4]

The Commission finds that participation in this proceeding by Highlands may be in the public interest. Accordingly, we shall grant Highlands' petition to intervene in this docket.

The Commission orders:

(A) The instant submittal is hereby declared to be jurisdictional and is accepted for filing to be effective as of June 1, 1971, *provided, however,* that the reasonableness of the apportionment arrangement shall be subject to the outcome of the proceedings in Docket Nos. EL78-18 and ER76-828, and subject to the refund provisions therein.

(B) The notice requirements of the Commission's regulations are hereby waived.

(C) Tapoco's request for waiver of additional filing requirements is hereby granted.

(D) NP&L is hereby directed within 30 days of the issuance of this order to file a certificate of concurrence with the apportionment agreement, which, upon filing, shall become effective as of June 1, 1971, subject to the outcome of Docket Nos. ER76-828 and EL78-18.

(E) Highland's petition to intervene is hereby granted, subject to the rules and regulations of the Commission; *provided, however,* that participation by the intervenor shall be limited to matters set forth in its petition to intervene; and *provided, further,* that the admission of this intervenor shall not be construed as recognition by the Commission that it might be aggrieved because of any order or orders by the Commission entered in this proceeding.

(F) Docket No. ER81-19-000 is hereby terminated.

(G) The Secretary shall promptly publish this order in the Federal Register.

[4]Docket No. ER80-574 involves NP&L's most recent wholesale rate change case.

APPENDIX H

Excerpts from Administrative Law Judge Decision,
Nantahala Power and Light Company,
Docket No. ER76-828;
Town of Highlands, North Carolina
v. Nantahala Power and Light Company,
Docket No. EL78-18;

[THIS PAGE INTENTIONALLY LEFT BLANK]

Nantahala Power and Light Company, Docket No. ER76-828; Town of Highlands, North Carolina, *et al.* v. Nantahala Power and Light Company, Docket No. EL78-18

Initial Decision

(Issued April 10, 1981)

Jacob Leventhal, Administrative Law Judge.

TABLE OF CONTENTS

Procedural History

On July 30, 1976, Nantahala Power and Light Company (Nantahala) tendered for filing proposed tariff provisions which provided for increased annual charges of $121,908 (28.2%) based on the test period ending December 31, 1975. The rate increase affects three wholesale customers, Haywood Electric Membership Corporation (Haywood), the Town of Highlands, North Carolina (Highlands) and Western Carolina University.

By order issued August 31, 1976, the Commission accepted the proposed increase for filing, subject to refund, suspended its effectiveness until October 1, 1976 and set the matter for hearing.

Petitions to intervene filed by North Carolina Electric Membership Corporation (NCEMC), Haywood and Highlands were granted.

The first prehearing conference was held on May 10, 1976. At that time Nantahala requested additional time to develop a cost of service rate to present in Docket E-9181, a related rate case. No further conferences were held until May, 1978.

On April 24, 1978 Highlands filed a complaint pursuant to Section 306 of the Federal Power Act against Nantahala, Tapoco, Inc. (TAPOCO) and the Aluminum Company of America

(Alcoa) in Docket No. EL78-18. The complaint alleged that Nantahala's rates are too high because of allegedly illegal activities engaged in by Alcoa. NCEMC and Haywood petitioned to intervene, in support of the complaint on June 9, 1978. The petition was granted and they filed an answer on July 10, 1978.

Docket EL78-18 was consolidated with the rate docket on motion of Highlands. A second prehearing conference was held on May 10, 1978. Thereafter there was extensive prehearing practice involving a number of motions with the attendant submission of briefs and oral arguments. Twenty-two days of hearing were held between April 8 and May 8, 1980. Initial and reply briefs were filed June 26 and July 31, 1981 respectively.

Because of the retirement and subsequent death of Presiding Judge Graham McGowan, this proceeding was assigned to me for determination. A final oral argument on the issues was held before me on October 17, 1980 and the parties filed indices to their respective briefs on October 28, 1980.

* * *

I. Docket No. EL78-18 The Complaint Proceedings

The complainants contend that Alcoa, through the guise of co-respondents Tapoco, and Nantahala, has violated the Federal Power Act by diverting facilities formerly dedicated to public service to its private use and benefit at the expense of Nantahala's ratepayers. In particular, Highlands alleges that Alcoa has: (1) assigned the best hydro-electric generating facilities in the western North Carolina region to its own service through Tapoco, Inc. and Tapoco's predecessors, while leaving Nantahala with facilities claimed to be more costly; (2) caused Nantahala to relinquish assets and contractual obligations for the benefit of Alcoa without receiving consideration in return; and (3) caused Nantahala to receive less than a reasonable share of the benefits arising from the New Fontana agreement.

In order to understand the nature of these allegations, a short synopsis of the various contractual agreements must be set forth.

1. Original Fontana Agreement (Tapoco Exh. 6) (August 14, 1941). A twenty year agreement between Alcoa and TVA which turned over land owned by Nantahala and Tapoco to TVA for the purpose of developing the Fontana Dam. This contract also provided that all of the generation of Nantahala's plants (with the exception of three small plants) and Tapoco's plants and effective control of two generating systems be turned over to TVA in return for a specified amount of power, 218.3 Mw.

2. New Fontana Agreement (Exh. of Answer) (December 27, 1962). This contract was similar to the prior agreement and continued some of its provisions. It changed the amount of entitlements from TVA to Nantahala, Tapoco and Alcoa. It was signed by all four parties, Alcoa, Tapoco, Nantahala and TVA.

3. 1963 Apportionment Agreement (Nantahala Exh. 42) (January 1, 1963). This was an agreement between Nantahala and Alcoa which divided, between the two utilities, the entitlements from the New Fontana Agreement. Nantahala received, each month, $^1/_{12}$ of its annual primary energy capability of 360,000,000 kwh or its actual generation and $89,200 per year from Alcoa for allowing TVA to operate its projects. In this and the following agreement, the balance of the entitlements go to Tapoco.

4. 1971 Apportionment Agreement (Nantahala Exh. 44) (June 1, 1971). Essentially a revision of the allocations made in the 1963 contract. Alcoa was not a party to this contract. Nantahala's energy entitlement was fixed at 360,000,000 kwh annually and its capacity limitation was 54.3 Mw. The $89,200 payment was not mentioned and hence terminated.

A brief history of the operations of Alcoa and its electric power subsidiaries will clarify the allegations of the compaint.

Alcoa conducts aluminum smelting operations in the town of Alcoa, Tennessee. As aluminum smelting is a process requiring large amounts of energy, Alcoa has, over the past years, set up

corporate subsidiaries which generate electricity and sell it to Alcoa. They are Tapoco, Nantahala, and Carolina Aluminum Company.

Tapoco is the current name of what was originally the Knoxville Power Company. Incorporated in the State of Tennessee in 1900, the company was acquired by Alcoa in 1910, and its primary function until 1945 was to service a public load in Blount County, Tennessee with power purchased from other companies. In 1927, Knoxville Power Company began construction of the Calderwood hydro facility on the Little Tennessee River which was transferred in 1929 to Alcoa upon the order of the Tennessee Railroad and Public Utilities Commission. In approving the transfer, the Tennessee Commission explicitly noted the intention of Knoxville and Alcoa that all power and energy produced at the Calderwood facility be used by Alcoa in its Tennessee smelting operations (Tapoco Exh. 11, pp. 1-2; Tr. 2634). Operations of the Calderwood facility began in 1930 and, in 1945, the project was reacquired by Knoxville from its parent company.

In 1954, Knoxville Power changed its name to Tapoco, Inc. The following year the company obtained a certificate of public convenience and necessity from the Tennessee authorities for the construction of the Chilhowee hydro project, also located on the Little Tennessee River and the Federal Power Commission issued a joint license to Tapoco and Carolina Aluminum Company to operate the Calderwood facilities, plus the existing Cheoah and Santeetlah hydro facilities. Later in 1955, Tapoco acquired these last two developments from Carolina Aluminum and transmission facilities from Nantahala, consisting of a line from the Santeetlah facility to the North Carolina-Tennessee border. Also that year, Tapoco sold its distribution system and public service franchise to the City of Blount, Tennessee. As a result, Tapoco's output has, since 1955, been entirely dedicated to Alcoa's smelting operations. The company has not been regulated by either the Tennessee Public Service Commission or the North Carolina

Public Utilities Commission. However, in 1954, Tapoco was domesticated in North Carolina (Tapoco Exhibit 17) in connection with its application to acquire the Santeetlah and Cheoah projects. Tapoco is a "licensee" under Title I of the Federal Power Act and a "public utility" within the scope of Title II of the Act. Accordingly, the company's power sales agreement with Alcoa is on file with this Commission.

Nantahala was incorporated in North Carolina in 1929 and has been subject to regulation by the North Carolina Public Utilities Commission as well as this Commission and its predecessor, the Federal Power Commission (FPC). The company serves six counties in western North Carolina and has as its primary resource eleven hydro generating plants, ten of which are located on the Little Tennessee River. As a result of the increase in demand that occurred in World War II, Alcoa commenced the purchase of power from Nantahala, which constructed the Nantahala and Thorpe projects primarily to meet this increase in demand. Originally, the hydroelectric facilities were constructed after filing applications with the FPC, which determined that no license was required. In 1966, the FPC reversed its prior findings. See 36 F.P.C. 119 (1966). These sales to Alcoa ceased in 1971 as a result of the increase over the years placed upon Nantahala by other public load customers.

A third power company, Carolina Aluminum Company, should be mentioned. Chartered in North Carolina in 1905, the company was originally known as the Tallahassee Power Company (Tallahassee) and its purposes included the development and supply of public and private loads, both in North Carolina and out-of-state. Alcoa acquired Tallahassee in 1911. Its principal activities included acquisition of land rights to develop the Cheoah project, completed in 1919, and the Santeetlah project, which was completed and commenced service in 1929. The construction of the latter project included the use of eminent domain and culminated in one court decision, ***Whiting Manufacturing v. Carolina Alumi-***

num Company, 207 N.C. 52, 175 S.E. 698 (1934). The bulk of the power generated at the Cheoah and Santeetlah plants was transmitted to Knoxville Power Co. for delivery to Alcoa. In 1929, Tallahassee sold its undeveloped power sites in western North Carolina to Nantahala. In 1931, the company changed its name to Carolina Aluminum Company and, in 1955, sold the Cheoah and Santeetlah developments to Tapoco, Inc.

As indicated, practically all the hydroelectric facilities owned by Nantahala and Tapoco are located on the Little Tennessee River. Separating the two companies' generation sites is the Fontana project; Nantahala's hydro projects are all located upstream of the Fontana dam, while Tapoco's are all downstream.

The Fontana hydro project was developed by the Tennessee Valley Authority (TVA). Originally, Nantahala desired to develop the Fontana Site, as evidenced by its declaration of intention to the FPC in October, 1940. See *Nantahala Power & Light Company*, 2 F.P.C. 833 (1940). Subsequent to the Commission's decision that a license would be required for the Fontana dam, while Tapoco's are all downstream.

The Fontana hydro project was developed by the Tennessee Valley Authority (TVA). Originally, Nantahala desired to develop the Fontana Site, as evidenced by its declaration of intention to the FPC in October, 1940. See *Nantahala Power & Light Company*, 2 F.P.C. 833 (1940). Subsequent to the Commission's decision that a license would be required for the Fontana dam, the plans to go ahead were dropped. Instead, the original Fontana agreement was executed in 1941 by TVA and Alcoa. The original Fontana agreement was superseded by the New Fontana Agreement (NFA) which became effective on January 1, 1963. Since neither of these agreements specified how the power and energy were to be divided as between the two Alcoa subsidiaries, the two apportionment agreements were executed. The 1963 one was never filed with the FPC and the 1971 agreement was finally

filed in 1980. Additional power and energy necessary to serve Nantahala's public load is purchased from TVA.

Highlands' position is that Alcoa's control of Nantahala and Tapoco has been used to obtain power at a low cost to the detriment of Nantahala's customers. Highlands proposes several remedies. First, it asks that the corporate veil between the two utilities be pierced and that they be considered one entity for ratemaking purposes. The cost of service should be established on a rolled-in basis of the combined power systems. Second, Highlands requests that the 1971 Apportionment Agreement be reformed to reflect a more fair and reasonable allocation of power and energy to Nantahala. Finally, it asserts that all of the agreements not currently filed be filed with this Commission.

Ruling

* * *

Highlands has not sustained its burden of proof on the issue of piercing the corporate veil and combining the two utilities for rate making purposes. Nantahala and Tapoco are separate entities. They were chartered in separate states; were developed separately; served separate customer loads; are not integrated except as part of the TVA system; are interconnected at only one point; and have separate corporate headquarters.

Whether Tapoco is recognized as a public utility by the Supreme Court of the State of North Carolina is not determinative of the issue before this Commission.

The substance of the complaint is that Highlands alleges an unfair and unjust allocation of power and facilities under the various agreements. To remedy this situation, it is not necessary to pierce the corporate veil. As discussed below, a more appropriate relief is available. This relief is to set rates for Nantahala as if the 1971 Apportionment Agreement were reformed to reflect a fair allocation of power and energy to Nantahala.

Highlands, in its complaint, and staff, in its brief, aver that the 1971 Apportionment Agreement is not fair and reasonable to Nantahala. It is Highlands' position that both the capacity and energy allocations are unfair while staff argues that this is true only with respect to the energy allocations. Their positions regarding the other agreements also differ.

Staff asserts that only the 1971 agreement is unfair. They agree with the respondents that the New Fontana Agreement (NFA) was negotiated at arms-length and is fair and reasonable. (R.B. at 14-16) According to staff, the record supports the respondents' argument that Nantahala was adequately compensated for that which it gave to TVA and its interests were protected during the negotiations. This, staff asserts, is not true of the 1971 agreement. Mr. Foreman, staff's witness, testified that Nantahala's share of the energy entitlements flowing from NFA are not proportional to the energy it turns over to TVA under NFA. It is his position that Nantahala's rates should be set as if it were receiving a larger share of the energy. Staff also argues that since the 1971 agreement is a contract affecting rates, it should have been filed with the Commission when made and the failure to make a timely filing should result in the imposition of sanctions. (Tr. 3534)

Highlands' position encompasses that of staff and goes well beyond it. Specifically, Highlands argues that the entitlements from NFA are designed to meet Alcoa's needs and that the lion's share of those entitlements are allocated to Tapoco, Alcoa's electric supplier, under the 1971 Apportionment Agreement. They cite to numerous documents which allegedly show that the primary concern during the negotiations for the agreements was to assure that Alcoa would have an adequate supply of power. This latter point is also argued with respect to the original Fontana Agreement and the 1963 Apportionment Agreement, although both of them have been superseded by the two later agreements. As does staff, Highlands avers that the filing issue is not moot. It takes the position that the lack of a timely filing gives

rise to a presumption that the 1971 Agreement was not fair and reasonable. (R.B. pp. 15-17)

All of these issues are contested by the Respondents. They contend that the 1971 Agreement cannot be reformed for two reasons. First, this is a contract which, under the *Mobile-Sierra* doctrine, cannot be altered except after a showing that it is not in the public interest, and neither staff nor Highlands has made this showing. Additionally, even if such a showing is made, the contract may only be modified prospectively. (R.B. p. 5-7) Secondly, since the entitlements being allocated under the agreement are fixed by the NFA, any increase in Nantahala's share will necessarily decrease Tapoco's share. Thus, even if Nantahala did not receive all that it is entitled to, there is no showing that Tapoco has received more than its share or even that it has obtained its fair share. Correcting an alleged injustice to Nantahala by doing a wrong to Tapoco is wholly improper.

The respondents hold that staff's position is analytically flawed in that their witness fails to properly distinguish the different types of power to be allocated. This, they contend, is also true of Highlands' witness, Mr. Springs. As to Highlands' arguments directed toward the negotiations for the above agreements, the Respondents assert that these arguments are nothing more than a negative inference which does not satisfy the burden of proof Highlands has in its position as a complainant. Moreover, regardless of what occurred during the negotiations, the end result is not unfair to Nantahala or its ratepayers. Finally, the respondents assert that the filing issue is moot since the 1971 Agreement has been filed with the Commission.

The first issue to be dealt with is the filing issue. There can be no question that the 1971 Apportionment Agreement is a contract affecting, in some manner, rates and charges under § 205(c) of the Federal Power Act and should have been filed when made.[1]

[1] 16 USC 824d(c), Regs. § § 35.1 & 2.

However, Nantahala's failure to make a timely filing does not give rise to any sanctions assessable by an administrative law judge. Nor does that failure give rise to a presumption that the 1971 agreement is unreasonable. The respondents are not, as Highlands argues, placed in a better position by their failure to file than if they had filed. Even if the agreements had been filed, Highlands, as a complainant, would still need to establish its *prima facie* case and the respondents would still have the ultimate burden of persuasion.

The next issue is the alleged unfairness of the 1971 Apportionment Agreement. In its brief, Highlands attacks all four of the agreements listed at the outset of this discussion as unfair and unreasonable. Although the original Fontana Agreement and the 1963 Apportionment Contract have been superseded, Highlands argues that they are unfair and unreasonable apparently to demonstrate the continuing nature of the alleged improprieties with regard to Nantahala and also because there is a carry-over of some of the provisions of the two prior agreements to the current agreements. However, those arguments relate to its requested relief that Nantahala and Tapoco be combined. Since that relief has been ruled inappropriate, the remaining discussion will be limited to the 1971 agreement.

According to Highlands and staff, the 1971 Apportionment Agreement should have allocated the power available from TVA under NFA according to each utility's proportionate contribution to the power made available to TVA, but, instead, it gave too little power to Nantahala. Respondents submit a study (Apportionment Study) which they allege is the basis of the 1971 Agreement and demonstrates the fairness of that contract. However, there is a substantial amount of evidence showing that the respondents' position is untenable.

Probably the strongest evidence relates to the fact that the 1963 Agreement, which was supposed to be effective for the term

of NFA, was superseded by the 1971 Agreement. Staff's witness, Mr. Foreman and Highlands' witness, Mr. Springs, agree that the earlier agreement provided greater benefits to Nantahala, (Tr. 3310-34; 1961 respectively) such as the $89,200 payment by Alcoa. Yet the respondents offer no evidence as to what Nantahala received in exchange for surrendering its rights under the 1963 contract for the less favorable 1971 Agreement. The respondents defend Nantahala's agreeing to the later contract on the grounds that the earlier contract was rendered moot by the North Carolina Utilities Commission. (Tr. 1389) However, a reading of the decision of the State Commission and the testimony of Nantahala's witness shows that only a part of that contract was affected by the State Commission's decision. The allotment of power was unaffected. Additionally, Mr. Foreman testified that Alcoa and Nantahala continued to abide by the terms of that agreement after it was allegedly nullified by the State Commission. (Tr. 3312) Hence, it must be concluded that the evidence shows that Nantahala, without any compensation, gave up its rights under the 1963 Agreement.

Mr. Foreman and Mr. Springs also attempt to show that the 1971 Apportionment Agreement is unfair in that Nantahala is not allocated the proper share of the NFA power. Mr. Springs' analysis is essentially a comparison of Nantahala's generating capability and its share of power and energy under the 1971 contract. He argues that since the former is less than the latter, the agreement is not fair. (Tr. 1956-59) The problem with his analysis is that it ignores any trade-offs in the NFA. That is, under the NFA, the two utilities receive less power and energy than they turn over to TVA ostensibly because of other benefits derived from TVA, such as downstream benefits. Since the NFA entitlements are not equal to the total of the generation of the two utilities, Nantahala should not be allocated its generation as its share of the NFA entitlements. Thus, Mr. Springs' proposed allocation must be rejected.

Mr. Foreman's analysis and recommended allocation is more reasonable. His proposed allocation to Nantahala is that portion of the NFA entitlements which is proportionate to Nantahala's contribution to the power turned over to TVA. (Tr. 3316-17) That is, he finds that Nantahala's potential energy generation is 22.5% of the potential energy generation turned over to TVA and therefore Nantahala should be allocated 22.5% of the energy entitlements under NFA, or 404,268,300 kwh. (Tr. 3325) His analysis also shows that Nantahala's capacity credit should be 68.3MW. (Tr. 3327) He recommends that rates be set accordingly and, after the 1971 Agreement is filed, that it be reformed to reflect these changes.

Respondents take issue with Mr. Foreman's calculations. They argue that if Nantahala should get a certain percentage of the NFA entitlements, then it should take that percentage of uninterruptible and interruptible energy and Nantahala should not first take all of the uninterruptible energy. If Mr. Foreman were consistent, they argue, the cost of purchased power would actually be far greater than its present level since all of the interruptible energy would need to be firmed up. (R.B. pp. 7-12) They also assert that the *Mobile-Sierra* doctrine prevents any change in the contracts. (R.B. 5-7)

The respondents' *Mobile-Sierra* argument misinterprets that doctrine. Those cases applied only to contracts in which the rates were set, not to contracts whose costs may be flowed through to the ratepayers. If their argument were accepted, then any agreement whose costs affect a utility's rates (e.g. fuel supply contracts, construction contracts) could not be reviewed except under § 206. This is not the import of that doctrine, and, therefore, this argument must be rejected.

Similarly, the respondents' other argument must also be rejected. Essentially they assert that Mr. Foreman ignores the distinction between primary and secondary power. Yet they accepted his

definitions when they cited, with approval, the staff's position on the fairness of the NFA. (R.B. p. 40) Staff's position there was also based on Mr. Foreman's analysis. Moreover, this distinction was apparently considered unimportant by Alcoa under the 1963 Apportionment Contract where Nantahala was entitled to a varying amount of energy dependent on its actual generation. That contract would have allowed Nantahala to be credited for an amount of energy greater than the 360 Mw of *uninterruptible* energy available under NFA. (Nantahala Ex. 42, p. 2) Finally, respondents' argument that Nantahala received all of the "primary" energy and none of the secondary energy because it could only use the former and not the latter without firming it up (R.B. pp. 9-13) would mean that there could not have been any meaningful negotiation in the 1971 agreement because the parties were already locked-in to an allocation due to the nature of the NFA entitlements. Since the respondents contend, in effect, that the 1971 contract was a bargained for exchange, there had to have been room to negotiate. Hence, their arguments show a good deal of inconsistency. The record supports Mr. Foreman's allocation and the rates should be set as if that were the allocation used.

The respondents are correct in asserting that the 1971 contract may not be reformed. Although there is ample evidence in the record demonstrating that Nantahala was not accorded its fair share of the power, there is little convincing evidence that Tapoco unfairly benefitted from that misallocation of power. Mr. Springs attempted to do this, but his analysis is so closely tied in with his argument that the two utilities should be combined that the two positions cannot clearly be separated. Thus, Highlands has not even made out a *prima facie* case for reformation.

Therefore, the rates should be set as if the 1971 Agreement allocated the NFA entitlements as Mr. Foreman proposed, but the agreement should not be reformed.

* * *

Ultimate Findings and Conclusions

Upon consideration of the record in this proceeding, I find that:

1. Nantahala Power and Light Company is a public utility under the Federal Power Act.

2. The proposals at issue involve sales of electric power at wholesale in interstate commerce and are subject to the jurisdiction of this Commission.

3. The changes in rates and charges, except to the extent heretofore specifically approved, have not been shown to be just and reasonable and they are found to be excessive or otherwise unlawful.

4. The just and reasonable rates and charges are those which are in conformity with the findings and conclusions set forth in this decision.

5. Nantahala is required to refund to its jurisdictional customers any amounts reflecting the difference between its proposed rates and the rates found just and reasonable pursuant to this decision.

6. Any relief requested in the complaint proceedings not specifically granted is denied.

* * *

APPENDIX I

Excerpts From FERC Opinion No. 139,
Nantahala Power and Light Company,
Docket No. ER76-828-000;
Town of Highlands, North Carolina
v. *Nantahala Power and Light Company,*
Docket No. EL78-18-000

Nantahala Power and Light Company, Docket No. ER76-828-000

Town of Highlands, North Carolina, et al. v. Nantahala Power and Light Company, Docket NO. EL78-18-000

Opinion NO. 139, Opinion and Order Modifying Initial Decision

(Issued May 14, 1982)

Before Commissioners: C.M. Butler III, Chairman; Georgiana Sheldon, J. David Hughes and A.G. Sousa.

This consolidated proceeding involves a July 30, 1976 rate increase filing by Nantahala Power and Light Company (Nantahala) and an April 24, 1978 complaint filing pursuant to Section 306 of the Federal Power Act by the Town of Highlands, North Carolina (Highlands). The matters were consolidated by the Commission on November 22, 1978, because certain issues of corporate misuse were raised by Highlands in both proceedings.

In Docket No. ER76-828, Nantahala seeks an annual rate increase of $121,908 (28.2%) to three wholesale customers: Highlands, Haywood Electric Membership Corporation (Haywood), and Western Carolina University. The proposed rates are based on the test period ending December 31, 1975. They are effective, subject to refund, for the locked-in period October 1, 1976 to March 1, 1981.

In Docket No. EL78-18, Highlands alleges that Aluminum Company of America (Alcoa) and its wholly owned subsidiaries, Nantahala and Tapoco, Inc. (Tapoco), are in violation of the Federal Power Act by diverting, for the benefit and private use of Alcoa, hydroelectric power and facilities dedicated to public service. Highlands is supported in its complaint by Haywood and the Attorney General of the State of North Carolina (Complainants/Intervenors).

The numerous issues raised in these proceedings were heard in April and May 1980, by Presiding Judge Graham McGowan,

who retired and died prior to a determination of the issues. Judge Jacob Leventhal was assigned to the dockets and heard a final oral argument on the issues October 17, 1980. He issued an initial decision April 10, 1981.

Briefs on and opposing exceptions to the initial decision have been filed by the Commission staff, Nantahala, Complainants/Intervenors, Tapoco and Alcoa. The issues raised in the exceptions included demand cost allocation, cash working capital, purchased power adjustment clause, rate of return, restatement of depreciation charges, and numerous substantive and procedural matters raised in the complaint proceeding.

Based on the record evidence, we affirm and adopt the initial decision on all issues except rate of return.

I. Docket No. EL78-18 Complaint Proceeding

A. *Background*

At issue in this complaint proceeding is the appropriate allocation of costs associated with certain hydroelectric developments along the Little Tennessee River. The flow of the Little Tennessee River is regulated by the Tennessee Valley Authority (TVA) through the Fontana Dam, which was developed by TVA in the 1940's, and control by TVA of hydroelectric facilities along the river which are owned by Nantahala and Tapoco. Nantahala owns hydroelectric projects upstream of Fontana Dam, while Tapoco owns projects downstream.

Nantahala and Tapoco are both wholly owned subsidiaries of Alcoa, which conducts aluminum smelting operations in Alcoa, Tennessee. Currently, Tapoco is the industrial power supply source for Alcoa's Tennessee smelting operations, while Nantahala serves a public utility load in western North Carolina. Although Tapoco (originally the Knoxville Power Company) functioned primarily to serve a public load in Tennessee until

1945, it has since 1955 devoted its output entirely to Alcoa's smelting operations. At the time of the hearing, it was not regulated by either the Tennessee Public Service Commission or the North Carolina Utilities Commission. Nantahala was created as a public utility in western North Carolina in 1929 and although it sold excess power to Alcoa until approximately 1971, sales to Alcoa then ceased due to increased demand by its public service customers. Nantahala is regulated by the North Caolina Public Utilities Commission.[1]

In 1941, Alcoa and TVA entered into the Original Fontana Agreement (OFA), a 20-year contract by which land owned by Nantahala was turned over to TVA for development of the Fontana Dam, and control of a number of Nantahala and Tapoco generating facilities was given to TVA. All of Nantahala's generation, except for three small plants, was included. In exchange, TVA agreed to provide Alcoa with a continuous stream of 11,000 kW for the term of the contract.

In 1962, a new Fontana Agreement (NFA) was executed by Alcoa, TVA, Nantahala and Tapoco. The agreement was similar to the original one, but TVA, instead of supplying Alcoa with electricity, agreed to give to Nantahala and Tapoco average annual entitlements of 1,798,000,000 kWh. Alcoa, Nantahala and Tapoco were to agree among themselves as to allocation of the entitlements. This contract is on file with the Commission as Tapoco Rate Schedule No. 3.

To allocate the entitlements from TVA, Nantahala and Alcoa entered into a 1963 Apportionment Agreement which provided that Nantahala's monthly share of the NFA entitlements would be the larger of either its total actual generation output or one-twelfth of its annual primary energy[2] capability of 360 million

[1]A more detailed description of the history of Nantahala and Tapoco is set forth at pp. 6-8 of the Initial Decision.

[2] "Primary" energy is the amount of energy generation which is virtually assured under the most adverse generation conditions. It is a theoretical minimum annual potential generation.

kWh. The balance of the entitlements was to go to Tapoco. The agreement further provided that Alcoa would pay Nantahala $89,200 per year for allowing TVA to operate its projects. This agreement was never filed with the Commission.

The 1963 Apportionment Agreement was revised by Nantahala and Tapoco, who entered into a 1971 Apportionment Agreement (Alcoa was not a party). This agreement, still in effect, limits Nantahala's share of the TVA entitlements to 360 million kWh annually. Unlike the 1963 contract, it also limits Nantahala's demand to 54,300 kW. The $89,200 annual payment by Alcoa to Nantahala is eliminated. All remaining entitlements go to Tapoco. The agreement was not filed with the Commission until 1980.

Because Nantahala's TVA entitlements are not sufficient to serve its public service load, the utility purchases additional power from TVA at approximately 19.5 mills per kWh[3]. Tapoco sells power to Alcoa at approximately 2.4 mills per kWh.[4] Adoption of Complainants'/Intervenors' position in this proceeding would eliminate cost allocation under the above described contracts and instead would compute the wholesale cost of service by rolling in the low cost Tapoco energy with the high cost TVA purchases, resulting in a lower average cost of power.

B. *Complaint Allegations*

Highlands' complaint alleges that Alcoa, Nantahala and Tapoco have violated the Federal Power Act by diverting for the benefit and private use of Alcoa hydroelectric power and facilities dedicated to public service. It claims the diversion has been accomplished by the following practices:

[3]Nantahala 1975 Form 1, p. 423, col. q. The cost of this power is passed on to Nantahala's customers through a purchased power adjustment clause, also at issue in this proceeding.

[4]Tapoco 1975 Form 1, p. 414, col. f.

(1) Alcoa has assigned the best hydroelectric generating facilities dedicated to the public service in the region to its own service through Tapoco and Tapoco's predecessor companies, leaving Nantahala to serve the public load with facilities which are claimed by Nantahala to be currently inadequate.

(2) Alcoa has caused Nantahala to relinquish assets and contractual obligations for the benefit of Alcoa without consideration.

(3) Alcoa has caused Nantahala to pool its generating resources pursuant to the terms of the NFA, but Nantahala is denied a reasonable share of the benefits of coordinated operations as power is divided between Tapoco and Nantahala.

Highlands contends that because Nantahala and Tapoco have commingled their assets and liabilities under the NFA, it is not possible to derive a rational method of apportioning costs and benefits on any basis other than a rolled-in cost of service. The town asks the Commission to pierce the corporate veil between the two utilities and treat them as one entity for ratemaking purposes, to set aside the 1971 Apportionment Agreement, to develop Nantahala's rates on a rolled-in cost of service basis, and to order Alcoa and Tapoco to establish an interconnection with Highlands. If rolled-in costing is not adopted, Highlands believes the Commission should set aside all purchased power expense claimed by Nantahala resulting from the misallocation of power received from TVA as consideration for the NFA.

C. *Discussion*

The presiding judge concluded that Highlands has not sustained its burden of proof on the issue of piercing the corporate veil and combining Nantahala and Tapoco for ratemaking purposes. However, he determined that allocation under the 1971 Apportionment Agreement is unfair. Although he refused to reform the contract, he concluded that rates should be set as if the

1971 Agreement allocated the NFA entitlements as proposed by the Commission staff. This allocation would give Nantahala that portion of the NFA entitlements which is proportionate to Nantahala's contribution of the power turned over to TVA.[5] The judge also determined that the 1971 Agreement is a contract affecting rates and charges under §205(c) of the Federal Power Act and should have been filed when made, but that Nantahala's failure to timely file does not give rise to any sanctions assessable by an administrative law judge.

Complainants/Intervenors except to the judge's decision not to require a rolled-in cost of service and the filing of joint rate schedules by Nantahala and Tapoco, the failure to recommend sanctions for the failure to file timely rate schedules, and the failure to recommend reformation of the 1971 Apportionment Agreement. The Commission staff also objects to the lack of sanctions for failure to file jurisdictional rate schedules. Nantahala excepts to the judge's adjustment of entitlements under the New Fontana Agreement.

There appears to be considerable confusion in this proceeding as to the relationship between burden of proof and establishment of a *prima facie* case. As the judge properly points out, the burden of proof in a §206 complaint proceeding is on the complainant.[6] The burden consists of coming forward with a *prima facie* case and once this initial burden is met, the burden shifts to the respondent to make an affirmative defense.[7] The judge does not distinguish the test for ultimate burden of proof from that of establishing a *prima facie* case. The test for *prima facie* evidence is whether there are facts in evidence which if unanswered would

[5]Tr. 3316-17.

[6]Section 556(d) of the Administrative Procedure Act controls allocation of burden of proof in a §206 proceeding, and places the burden on "the proponent of a rule or order . . .".

[7]*Public Service Company of New Hampshire*, Opinion No. 37, Docket No. ER76-285 (March 30, 1979 [6 FERC ¶—]) mimeo at 5.

justify men of ordinary reason and fairness in affirming the question which the plaintiff is bound to maintain.[8]

As discussed below, we do not agree that Highlands has not made a *prima facie* case as to any elements of its complaint. However, such a finding does not end the matter since it means only that the initial burden of going forward on a particular allegation of the complaint has been met. Our decision must be based on the weight of the *total* evidence, including that which the respondents present to rebut or discredit the proponent, and any available sanctions may be imposed by us according to a preponderance of the evidence.[9]

We conclude that Highlands has made a *prima facie* case to show the unfair benefits to Alcoa which have resulted from the 1971 Apportionment Agreement. However, we do not find there is substantial evidence to support a finding that the Nantahala and Tapoco systems should be treated as one, or that rolled-in costing should be adopted.

The central question to resolve here is whether a preponderance of the evidence supports a finding that Alcoa has used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act. "While corporate entities may be disregarded where they are made the implement for avoiding a clear legislative purpose, they will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages and where no violence to the legislative purpose is done by treating the corporate entity as a separate legal person."[10] Where a statutory purpose can be easily frustrated through the use of separate corporate entities, a regulatory commission may look through the corporate form and

[8]9 *Wigmore on Evidence* §2494, at 387 (3d ed. 1981) (citations omitted).

[9]*Steadman v. S.E.C.*, 49 U.S.L.W. 4174 (February 25, 1981).

[10]*Schenley Distillers Corp. v. U.S.*, 326 U.S. 432, 437 (1946).

treat the separate entities as one and the same for ratemaking purposes.[11]

Based on the evidence presented, we cannot find that Alcoa has used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act, or that the two companies operate as an integrated system. Nantahala and Tapoco were developed in different states and for different purposes;[12] their customer loads and sources of generation are geographically separate;[13] their management is separate;[14] and they are interconnected at only one point.[15] The two companies do not constitute an integral unit between themselves but are each a part of the coordinated TVA system, and it is TVA who controls and dispatches most of the generation from their respective generating plants.

Complainants/Intevenors cite to Commission Opinion No. 711 (*Georgia Power Co.*, 52 FPC 1343 (1974)) in support of their argument that Nantahala and Tapoco constitute an integrated system whose costs should be allocated on a rolled-in basis. Although the Commission rejected rolled-in costing in *Georgia Power*,[16] Complainants/Intervenors claim the case holds that rolled-in

[11]*General Telephone Co. of the Southwest v. U.S.*, 449 F.2d 846, 855 (5th Cir. 1971).

[12]Tr. 2373-2376; Tr. 1382-1384; Exhs. N-33 and N-34; Tr. 2634-2635.

[13]*Id.* All but one of Nantahala's plants are above the Fontana Dam Project, while Tapoco's are below. Although both companies turn over all of their output to TVA, Nantahala serves only customers in North Carolina, while all of Tapoco's customer load is in Tennessee.

[14]Exhs. S-14 and S-15; Tr. 2647; Tr. 2438-39.

[15]Exh. C/I-50. The companies are integrated through a single 161 kV line. Tr. 2383.

[16]In *Georgia Power*, the Commission rejected an argument that the costs of Georgia Power Company and Alabama Power Company, both part of the integrated Southern System Power Pool, should be allocated on a systemwide basis. Such allocation would have reduced Georgia Power's wholesale rates at the expense of Alabama Power, which had a relatively large low-cost hydroelectric capacity.

costing is appropriate where: (1) a complaining customer can show that the individual company approach is theoretically unsound because it fails to identify appropriate customer loads; (2) regardless of theory, it can be shown that customer cost responsibility is distorted by unreasonable power pool transactions. They claim they have met both of these criteria.

The record developed here does not support Complainants'/Intervenors' analysis of *Georgia Power* as applied to the unique facts of this case. As stated in *Georgia Power,* rates should be based upon costs related to the services rendered.[17] Nantahala and Tapoco serve separate customer loads and, unlike the companies in the Southern System, they do not exchange energy with each other. Any energy exchanges which take place are with TVA. Furthermore, as admitted by Complainants' witness on cross-examination, the fact that companies may be interconnected or have common dispatching does not necessarily require a finding that they constitute an integrated system or that rolled-in costing is appropriate.[18] Another of Complainants' witnesses admitted on cross-examination that Nantahala and Tapoco do not actually fit the definition of "System, Flectric" which appears in the Edison Electric Institute's Glossary of Electric Utility Terms.[19]

Complainants/Intervenors allege that Tapoco is a utility dedicated to public service in western North Carolina and that it used eminent domain powers to acquire sites for certain hydroelectric projects. They argue that Nantahala was a spin-off of

[17]52 FPC at 1349.

[18]Tr. 2083-2101. For example, the Southern System Companies exchange power with one another, have common dispatching, have interconnected transmission and coordinate plant additions, yet rolled-in costing has been rejected for them. Tr. 2090-2097.

[19]Tr. 2309-2310. This definition reads: "The physically connected generation, transmission, distribution, and other facilities operated as an integral unit under one control, management, or operating supervision." The witness had earlier stated his belief that the combined Nantahala and Tapoco facilities met this definition. Tr. 1979.

the former Tallahassee Power Company (a public service corporation whose name was later changed to Carolina Power Company), and that Tallahassee's assets in western North Carolina were later spun off to Tapoco in 1955. The evidence shows that in 1934 Tallahassee Power condemned one acre of land for the Santeetlah Project reservoir, which is now owned by Tapoco.[20] It has not been shown that Tapoco has condemned any land. We do not find this evidence or the fact that Nantahala and Tapoco acquired Tallahassee Power Company assets some 25 years apart supports a finding that the two companies should be treated as one, or that the Respondents have abused the Federal Power Act.[21]

It is next necessary to examine any intercorporate transactions between Nantahala and Tapoco which might distort customer cost responsibility. The pertinent transactions here are the Old and New Fontana Agreements and subsequent apportionment agreements, particularly the 1971 Apportionment Agreement. Upon review of these contracts, we agree with the presiding judge that the 1971 Agreement is unfair, but we cannot accept Complainants' contention that Alcoa, through the OFA or NFA, intentionally deprived Nantahala of adequate hydroelectric generating facilities to serve its public load.

The record shows that the 1941 OFA and 1962 NFA were the result of arms' length bargaining. The OFA was negotiated at a time when a rapid increase in electricity was necessary to supply the aluminum smelting facilities at Alcoa, Tennessee, for the war effort.[22] Prior to this time Nantahala primarily had served its small public service load in North Carolina. Nantahala's public service

[20]Tr. 2374; Exh. C/I-45.

[21]We note that subsequent to the hearings and briefing of this case, but prior to the initial decision, the North Carolina Utilities Commission issued a decision finding that Tapoco is a public utility under North Carolina law. However, the definition of "public utility" in North Carolina is peculiar to that state and not determinative of the issues to be decided here.

[22]Tr. 1383.

load was not great enough to support additional hydroelectric projects, but because of national defense needs, Nantahala accelerated development of its Nantahala and Thorpe projects to help supply more power to Alcoa.[23] Nantahala also contemplated developing the Fontana site but did not do so because the size of its load did not justify developing such a large project, TVA had Congressional authority to develop the site, and TVA could do so much faster than could Nantahala.[24] It was under this historical setting that Alcoa, as parent of Nantahala, entered into the OFA. Nantahala transferred to TVA its property rights in the Fontana area for approximately $1.9 million and gave control to TVA of a number of its generating facilities, including the Thorpe and Nantahala projects then under construction.[25] In exchange, Nantahala received the energy the Nantahala and Thorpe projects would generate, which was far in excess of the demands of its then existing North Carolina load.[26]

By the late 1950's, when the OFA was about to expire, Nantahala found it necessary to supply itself with a more firm power supply since its public load had grown from 3 MW in the 1930's to approximately 41.3 MW in 1962.[27] Firmer supply was also necessary for Alcoa, which was contemplating expansion at its Alcoa, Tennessee, operations.[28] At about the same time that negotiations for the NFA began, Nantahala sought to sell its distribution system to Duke Power Company in order to provide inexpensive and more reliable power to its customers.[29] Although this proposed transfer to Duke was being pursued and although Nantahala did not directly participate in the NFA negotiations, the record indicates the negotiators considered the possibility that the sale

[23]Tr. 1383; Tr. 2375.

[24]Tr. 1383-84.

[25]Tr. 1384; Exh. N-37.

[26]Tr. 1384.

[27]Tr. 2378.

[28]*Id.*

[29]Tr. 1386; Tr. 2680. The sale to Duke was approved by the North Carolina Utilities Commission and North Carolina Court of Appeals, but rejected by the North Carolina Supreme Court.

would not occur and that Nantahala's needs might have to be met in the NFA.[30]

The above history of the OFA and NFA indicates no intent on the part of any of the parties to ignore the needs of Nantahala's public service customers or deprive them of energy at just and reasonable rates.

The apportionment agreements are another matter. The 1963 Agreement between Alcoa and Nantahala was entered at a time when Nantahala had excess energy which it sold to Alcoa. By 1971, however, Nantahala not only had no excess energy to sell to Alcoa, but it also did not have sufficient energy to meet its public load requirements. The utility investigated the possibility of withdrawing from the NFA and negotiating directly with TVA for a firm energy and demand supply in exchange for the use of Nantahala's plants, as well as contracting for additional firm power necessary to meet its growing public load.[31] TVA informed Nantahala that even if Nantahala could withdraw from the NFA, TVA could not be expected to provide the company with any greater portion of firm power than is supplied proportionately under the NFA.[32] Nantahala then negotiated the 1971 Apportionment Agreement with Tapoco, so that it could reach an agreement on its Fontana entitlements before setting final arrangements with TVA for purchasing additional power.[33] Such an agreement was necessary because a significant portion of the total power entitlements received under the NFA were curtailable or interruptible, and Nantahala had to make sure it would receive firm capacity and energy necessary for a public load.[34]

The alleged fairness of the 1971 Agreement is not supported by the record. The 1963 Agreement gave Nantahala considerably

[30]Exhs. T-34 at 15, T-61 through T-67(A), and C/I-106 at 5.

[31]Exh. N-43.

[32]Id.

[33]Tr. 1389.

[34]Tr. 1390.

greater benefits than does the 1971 Agreement, and there is no indication in the record as to why Nantahala, without consideration, gave up those benefits. The 1963 Agreement gave Nantahala energy entitlements equal to the *greater* of: (1) its actual generation for the month *or* (2) $^1/_{12}$ of its annual primary generating capability of 360 million kWh. The 1971 Agreement limits Nantahala to 360 million kWh per year. Thus, in periods of favorable rainfall and stream flow, Nantahala's customers may have to pay for extra energy purchased from TVA even though Nantahala's facilities actually generate more energy than the customers require. Unlike the 1963 Agreement, which contained no capacity limitation for Nantahala, the 1971 Agreement also limits Nantahala's demand to 54,300 kW. The 1963 Agreement provided that Alcoa would pay $89,200 annually to Nantahala as compensation for allowing TVA to operate Nantahala's facilities. The record gives no explanation as to why these payments were dropped in 1971.

The 1963 Apportionment Agreement was to continue in effect during the term of the 1962 NFA, which was 20 years.[35] We cannot find the 1971 Agreement fairly represents the interests of Nantahala's customers since there is not sufficient evidence to show that Nantahala received any consideration for entering into the less favorable contract after approximately eight years under the NFA. As pointed out in the initial decision, the only explanation offered by Respondents was that a 1963 North Carolina Utilities Commission decision rendered the 1963 contract moot. The record does not bear this out since the NCUC orders themselves modified only Nantahala's retail sales arrangement, and did not even mention the apportionment contract.[36] Also, the staff witness testified that the parties continued to operate under the agreement until 1971, that Alcoa and Nantahala entered a July

[35]Exh. C/I-84 at 3.

[36]Docket No. E-13, Sub. 13. See Items 2 and 3 of July 14, 1978 Appendix to Town of Highlands brief in opposition to Nantahala's motion to sever.

31, 1971 contract which specifically terminated the 1963 Agreement, and that Nantahala's Forms No. 1 for the years 1963 through 1971 show a continuation of the $89,200 compensation payments.[37]

We agree with the judge and staff that the most equitable division of entitlements would give Nantahala that portion of the NFA entitlements which is proportionate to the utility's actual contribution of power turned over to TVA. Staff Exhibit 7 shows the actual net generation of the Nantahala and Tapoco facilities for the years 1963-1978. The total net generation for Nantahala for 1963-1969, the pertinent time period here, was 22.50 percent of the total combined net generation of the two companies for the same years. The appropriate energy entitlement for Nantahala therefore would be 404,268,300 kWh (22.50 percent of the total 1.8 billion kWh entitlements from TVA).[38] The appropriate capacity credit would be 54.3 MW.[39]

The 404,268,300 energy entitlement was derived as follows:

Total Average Energy Available (Normal Year)	1,796,748,000 kWh
Primary Energy (Normal Year)	1,071,014,667 kWh
times Entitlement Percentage	22.50
Nantahala's Primary Energy Entitlement	240,978,300 kWh
Secondary Energy (Normal Year) [1,796,748,000 Less 1,071,014,667]	725,733,333
times Entitlement Percentage	22.50
Nantahala's Secondary Energy Entitlement	163,290,000 kWh
Total Nantahala Energy Entitlement	404,268,300 kWh

[37]Tr. 3312-13.

[38]Tr. 3325.

[39]Exh. T-33; Tr. 2675-76. At Tr. 3318 the staff states that the amount of capacity from TVA under the Apportionment is equitable.

We note that the 404,268,300 figure represents an entitlement for the "average" year, not the test year amount. The average entitlement provides a reasonable and consistent amount of energy to Nantahala each year, and is not susceptible to variation in water flows as witnessed between the average and test year amounts. Also, the average is more consistent with the operations of hydroelectric systems and the time frame of the 1971 Agreement. We therefore conclude that Nantahala should use the "average" entitlement in developing its costs.

Our decision here does not reform the 1971 Agreement, and does not affect the elimination of the $89,200 annual compensation payment from Alcoa to Nantahala. The effect of this opinion is to provide entitlements to Nantahala which will result in just and reasonable rates to its wholesale customers.

To the extent that allocation of the energy entitlements pursuant to the 1971 Agreement has resulted in unnecessary energy purchases by Nantahala from TVA, we shall require Nantahala to make refunds to its customers for the locked-in period of this docket. Nantahala shall be required to refund, with interest, any amounts collected in excess of those which would have been payable by customers had Nantahala received entitlements as described in the preceding paragraphs.

D. *Filing Requirement/Sanctions*

Section 205(c) of the Federal Power Act provides:

> Under such rules and regulations as the Commission may prescribe, every public utility shall file with the Commission, within such time and in such form as the Commission may designate, . . . schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classification, practices, and regulations affecting such rates and charges, *together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.* [Emphasis added.]

The Commission staff claims the presiding judge properly held that the 1971 Apportionment Agreement is a contract affecting rates and charges under Section 205(c), but that the judge erred in failing to recommend civil sanctions against Nantahala and Tapoco under Section 315(a), for failing to timely file the 1963 and 1971 Apportionment Agreements. Complainants/Intervenors argue that the fairest sanction is to treat Nantahala and Tapoco as one company and adopt rolled-in costing. If this is not done, they assert that the case should be referred to the Justice Department for criminal prosecution.

The Commission agrees with the law judge that the Apportionment Agreements clearly are contracts affecting, in some manner, rates and charges under Section 205(c) of the Federal Power Act, and should have been filed when made. However, civil sanctions under Section 315(a) of the Act are not available. Section 315(a) provides:

> "Any licensee or public utility which willfully fails, within the time prescribed by the Commission, to comply with any order of the Commission, to file any report required under this Act or any rule or regulation of the Commission thereunder, to submit any information or document required by the Commission in the course of an investigation conducted under this Act, . . . shall forfeit to the United States an amount not exceeding $1,000 to be fixed by the Commission after notice and opportunity for hearing."

The Commission never issued an order to Nantahala or Tapoco to file either of the Agreements as rate schedules, the Agreements are not reports required under the Act or regulations, and are not documents required by the Commission in the course of an investigation.[40] We therefore conclude that sanctions are not appropriate.

[40]The evidence on which the staff and Complainants/Intervenors rely consists of a series of letters between Nantahala and the Commission between 1963 and 1968 (Exhs. C/I-89-92). The letters show that Nan-

(*Footnote continued on following page*)

* * *

Motion to Notice Facts

Nantahala filed a motion on July 13, 1981, requesting that the Commission take official notice of statistics which show Nantahala's actual generation in kWh and New Fontana entitlements for June 1980 through May 1981. The figures purportedly represent Nantahala's generation and entitlements under drought conditions, and state the total 12 months' generation net of losses as 268,488,000 kWh and the total entitlements as 360,036,000 kWh. Both the Complainants/Intervenors and Commission staff oppose the motion.

Nantahala's motion is denied. The company claims the proffered statistics completely refute the Commission staff witness' testimony, but it gives no source of the statistics and offers no explanation as to why Nantahala's generation under drought conditions during a one-year period should influence our analysis of the fairness of the 1971 Apportionment Agreement. The data does not include capacity figures for Nantahala, and provides neither capacity nor energy statistics for Tapoco during 1981. Also, the figures reflect TVA's operating control over Nantahala's reservoirs, rather than what Nantahala's generation would be were it dispatching its own generation to best meet its own load requirements.

The staff apportionment study, upon which we relied herein, was based on seven years of actual stream flows for Nantahala,

(*Footnote continued from preceding page*)
tahala filed *under protest* a certificate of concurrence in Tapoco's filing of the New Fontana Agreement as a rate schedule. The Secretary of the Commission accepted the certificate of concurrence and noted that the Alcoa-Nantahala reimbursement agreement should also be filed as a rate schedule. The company responded that it did not believe Nantahala's power sales arrangements with Alcoa are subject to Commission jurisdiction. This evidence does not prove that any sanctions should be imposed or any other actions should be taken by the Commission with respect to Section 315 or 316 of the Federal Power Act.

and was taken from Forms No. 1 filed by the company. The information here reflects only one year of data and does not indicate how the statistics were compiled. The figures used by staff, for the years 1963–1969, were the same ones available to the companies at the time the 1971 Agreement was negotiated. We believe those figures are a far more reliable means of evaluating the reasonableness of the agreement at the time it was made. Statistics based on an isolated year some ten years after the agreement was made are of no substantial value in determining the fairness of the apportionment.

* * *

The Commission orders:

(A) The initial decision issued in this proceeding on April 10, 1981, is affirmed to the extent not modified herein.

(B) Within 75 days of the issuance of this order, Nantahala shall file revised rate schedules and tariff sheets in accordance with the findings and conclusions herein.

(C) Within 30 days of the Commission's approval of the revised tariff sheets, Nantahala shall refund to its customers, with interest, any amounts collected which are in excess of those allowed herein.

(D) Within 30 days of making refunds, Nantahala shall file with the Commission, in writing and under oath, a report showing the amount of refunds made, the method of computation used, together with releases from its jurisdictional customers.

(E) Any exceptions to the initial decision not granted herein are denied.

[THIS PAGE INTENTIONALLY LEFT BLANK]

APPENDIX J

Excerpts From FERC Opinion No. 139-A,
Nantahala Power and Light Company,
Docket Nos. ER76-828-002,-003,-004,-005;
Town of Highlands, North Carolina
v. Nantahala Power and Light Company,
Docket Nos. EL78-18-002,-003,-004,-005

Nantahala Power and Light Company, Docket Nos. ER76-828-002, -003, -004, -005;
Town of Highlands, North Carolina, *et al.* v. Nantahala Power and Light Company, Docket Nos. EL78-18-002, -003, -004, -005

Opinion No. 139-A, Order Denying Rehearing

(Issued September 30, 1982)

Before Commissioners: C. M. Butler III, Chairman; Georgiana Sheldon, J. David Hughes, A. G. Sousa and Oliver G. Richard III.

On May 14, 1982, the Commission issued Opinion No. 139, an opinion and order modifying the initial decision issued in this proceeding on April 10, 1981. Applications for rehearing of Opinion No. 139 were filed by the Town of Highlands, North Carolina, *et al.* (Highlands), the Attorney General of the State of North Carolina, Nantahala Power and Light Company (Nantahala), Aluminum Company of America (Alcoa), and Tapoco, Inc. Highlands also filed a motion to lodge a June 8, 1982 order of the North Carolina Utilities Commission (NCUC) which deals with a recent Nantahala retail rate case before that Commission.

By order issued July 9 [20 FERC ¶ 61,026], the Commission granted rehearing for the sole purpose of further consideration, stayed the effect of Opinion No. 139 pending the issuance of an order on the merits of the issues raised on rehearing, and gave notice of its intent to act on Highlands' motion to lodge. This order addresses the merits of the various filings. Because many of the arguments raised on rehearing are repetitious and were already considered fully by the Commission, we will address only those matters which warrant further discussion.

Burden of Proof

Highlands and the Attorney General make three basic arguments on rehearing concerning the burden of proof in this con-

solidated proceeding: (1) the Commission erred in assigning the initial burden of proof to Complainants and in finding that Nantahala had carried its burden to justify its proposed rates and charges; (2) the Commission explicitly imposed the ultimate burden of proof on Complainants; (3) to the extent the Commission indicated that Complainants did not make a *prima facie* case as to all elements of their complaint, this conflicts with Judge McGowan's February 28, 1979 procedural order which preceded the actual hearing of the case.

Contrary to allegations of the Attorney General, the Commission did not conclude that the issues concerning the intercorporate relationships among Alcoa, Nantahala and Tapoco were raised exclusively in the complaint docket. Page 2 of Opinion No. 139 recognizes that the issues of corporate misuse were raised in both the complaint and the rate docket. The Commission properly placed the burden of proof in the complaint docket on the Complainants and the burden of proof in the rate increase docket on Nantahala.

As to the numerous arguments concerning whether or not Complainants established a *prima facie* case as to every element of their complaint, these arguments obscure the real question before us, that is, whether the *totality* of the evidence presented supports a finding that rolled-in costing should be adopted. As indicated on page 6 of our Opinion, the criterion for deciding the issues here is substantial evidence. Although the Complainants in a proceeding may establish a *prima facie* case as to their allegations, that satisfies only the initial burden of going forward with their burden of proof. The Commission must consider not only the *prima facie* evidence, but also all evidence to rebut or discredit the *prima facie* case. Our decision in both the complaint and the rate increase proceedings rests on a weighing of all the evidence presented.

Highlands and the Attorney General cite to Judge McGowan's February 28, 1979 pretrial order in which the judge stated, at pages 9-10:

> Nantahala, Alcoa and Tapoco have attempted to rebut the *prima facie* case of corporate misuse established by Highlands . . . a factual question remains as to whether or not Nantahala receives the proper benefit of its own capacity, energy, and storage contributions. This question cannot be resolved by summary disposition and must therefore be set for hearing.

Judge McGowan went on to pierce the corporate veil between Alcoa and Tapoco for the limited purpose of making Alcoa a party. What Highlands and the Attorney General neglect to observe in their arguments is that the judge expressly stated at page 15 of his order that he was treating Alcoa and Tapoco as one for limited procedural purposes and that he was in no way passing on the merits of Highlands' allegations. He further stated:

> . . . In addressing the merits of Highlands' allegations, Highlands may yet attempt to show that the Commission should further pierce the corporate veil which allegedly surrounds Alcoa, Tapoco and Nantahala so that these three companies may be treated as one for relief purposes. I intend no ruling on the substance of Highlands' other allegations at this time.

Opinion No. 139 in no way conflicts with Judge McGowan's procedural order. Furthermore, a finding that the 1971 Apportionment Agreement is unfair does not mandate a finding that the Nantahala and Tapoco systems should be treated as one for ratemaking purposes.

We recognize that the North Carolina Utilities Commission (NCUC), based on a similar record, reached a different conclusion concerning rolled-in costing. However, the question of whether to treat various entities as an integrated system for ratemaking purposes is not a purely factual question, but also rests on criteria which each ratemaking authority may deem relevant. The Attorney General argues that the Commission erred by giving controlling weight to the corporate separateness of Nantahala

and Tapoco, and affording this separate status a significance not afforded under North Carolina law. As discussed below, it is not true that our Opinion gave controlling weight to this factor, or any other.

Highlands and the Attorney General argue that the Commission gave improper weight to various factors such as corporate separateness, separation of management, and geographic separation of customer loads. We wish to emphasize that no one factor was decisive in our decision not to adopt rolled-in costing. Rather, our decision rests on a variety of factors mentioned in both the initial decision and at page 7 of our Opinion.

The Attorney General contends that the Commission improperly established as an element of Complainants' case the necessity of proving that Alcoa used the separate corporate indentities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act. However, as pointed out in Judge McGowan's February 28, 1979, pretrial order, Complainants themselves cited numerous cases for the proposition that the corporate veil may be pierced where separate corporate indentities have been used to avoid a clear legislative purpose. The Commission did not introduce any new element of proof for Complainants. Nor, as the Attorney General claims, did we introduce an element of intent by Alcoa to deprive customers of just and reasonable rates. Although we did look at Alcoa's intent during the formation of the companies and negotiations of the agreements at issue here, that was not determinative of the issue of whether separate corporate identities have been used to frustrate the purposes of the Federal Power Act.

The Attorney General next claims that Opinion No. 139 fails to address the effect the Fontana agreements have had on Nantahala's ability to render service at just and reasonable rates, and that the Commission ignored certain benefits Alcoa received under the agreements to the detriment of Nantahala. Specifically,

he points to the benefits Tapoco (and thereby Alcoa) receives from the storage contributions of Nantahala's upstream projects. TVA, through the Fontana Dam which is downstream of Nantahala, benefits from Nantahala's upstream storage. Tapoco, which is downstream from the Fontana Dam, in turn receives downstream benefits from TVA. Although Tapoco indirectly receives downstream benefits from Nantahala, the Attorney General ignores other trade-offs in the agreements such as the $89,000 per year compensation payment to Nantahala. Furthermore, the extent of any downstream benefits has not been shown in the record.

In reference to the Attorney General's contention that Opinion No. 139 does not enunciate and apply ascertainable standards relating to the statutory requirement that rates be non-discriminatory, he ignores the evidence which shows that there is a difference in the quality of service received. Although there is a price discrepancy in the rates paid by Nantahala and Tapoco, Nantahala receives all of the primary energy available under the NFA, and a majority of the firm capacity.[1] Tapoco receives the remaining curtailable and interruptible capacity and energy. The firm capacity available to Nantahala is capacity which is available 100 percent of the time and not subject to unit outages. The Commission staff, who originally advocated 68.3 MW of capacity for Nantahala, later retreated from this position and concluded that if the NFA structure were taken as given, the 54.3 MW of capacity to Nantahala is fair.[2] Given the type of capacity and Nantahala's capacity contributions, we agree.

[1]Exhs. T-32 and T-33. Nantahala receives 54.3 MW firm capacity. Its installed nameplate capacity is 97.2 MW. Tapoco receives 13 MW firm, 75 MW interruptible and 90 MW curtailable capacity. Tapoco's installed nameplate capacity is 326.5 MW.

[2]Tr. 3318. The presiding judge, in approving the staff's position, apparently mis-read the staff's final position concerning appropriate capacity entitlements. See Staff Brief Opposing Exceptions. Opinion No. 139 modified the initial decision to this extent.

Exclusion of Evidence

The Commission summarily affirmed the initial decision's exclusion of several exhibits by which Complainants/Intervenors sought to prove that the former owner of two Tapoco projects (Tallahassee Power Company) had the power to condemn the land on which those projects were built. These exhibits are C/I 39(a) to 39(d), C/I 40(a) to 40(h) and C/I 41(a) to 41(f). Highlands and the Attorney General object to our summary affirmance.

Highlands maintains in this proceeding that Tallahassee was a predecessor to Tapoco and Nantahala, and attempts to show through the disputed evidence that Tallahassee deliberately held itself out as a public utility having the right of eminent domain. Tallahassee's charter from the North Carolina legislature did grant the company eminent domain power. However, none of the excluded exhibits prove that the Tapoco facilities were dedicated to public service. Furthermore, all of the cases to which the exhibits relate represent claims which were settled and never went to trial, and are not relevant evidence to establish Highlands' claim that costs should be rolled-in.

Modification of Entitlements

Alcoa and Nantahala claim that Opinion No. 139 may result in confiscation of property by setting rates below Nantahala's actual costs. The order sets rates as though a portion of interruptible entitlements were allocated to Nantahala. Both parties contend that proper rates must reflect the cost of firming up the interruptible energy in order to make it usable to Nantahala. According to a study presented by Nantahala on rehearing, the cost of firming up the secondary energy would be $489,147 in the test year and $1.2 million at current costs. Nantahala claims the Commission, at a minimum, should grant rehearing so that it can consider whether the cost of firming up the secondary power attributed to Nantahala outweighs the benefit of such energy.

We deny rehearing on this issue. Nantahala's study of the costs associated with firming up the interruptible energy entitlements is extra-record evidence which was not subjected to cross-examination by any other parties. Nantahala had ample opportunity to submit such a study prior to the close of the record. It did not.

In determining just and reasonable rates in Opinion No. 139, the Commission did not choose to reform the 1971 Apportionment Agreement and was not concerned with the mechanics of how entitlements of energy from TVA are allocated to each party, as long as each party receives its fair share of energy based on that party's contribution of actual energy turned over to TVA. The mechanics of the proportions of both primary and secondary energy available from TVA rests with the parties. Our concern is that each party receive its proper entitlement. Nantahala entered into a 1971 contract which we find unfair. As a result, the company had to make purchases from TVA which otherwise would not have had to be made. Nantahala must bear the consequences of its acts and refund rates collected to recover the cost of the excess purchases.

* * *

Effect on Tapoco

Tapoco, Inc. has filed a statement of understanding or, in the alternative, an application for rehearing. The company states its understanding that Opinion No. 139 in no way modifies its jurisdictional power sales arrangements under its Rate Schedule Nos. 3 and 4. Under Rate Schedule No. 3, Tapoco receives capacity and energy entitlements from TVA in exchange for the output of its licensed hydroelectric project. Under Rate Schedule No. 4, it sells capacity and energy to Alcoa.

Tapoco's understanding is correct. As found by the presiding judge, no showing was made on this record that Tapoco has unjustly benefitted under these rate schedules. Accordingly, Tapoco's jurisdictional sales arrangements remain unaffected.

Effective Date of Rates

Highlands and the Attorney General of the State of North Carolina contend that the Commission's modification of Nantahala's entitlements can be prospective only, that it constitutes retroactive ratemaking, and is in violation of the filed rate doctrine. At the time of Nantahala's rate filing, the NFA was the only wholesale rate schedule in effect which governs interstate power supply coordination and sets compensation rights for Nantahala's dedication of resources to TVA. (The Apportionment Agreement was not filed until 1980.) Although the parties' arguments are somewhat unclear, their final contention is that because compensation from TVA to Nantahala and Tapoco is commingled under the NFA, the rates must be set on a rolled-in basis.

Alcoa and Nantahala also argue that the Commission's Opinion improperly modifies the NFA and Apportionment Agreement by retroactively imposing a different apportionment to Nantahala. Their arguments also are rather murky, and they cite to cases which address the filed rate doctrine to support their contention that changes in Nantahala's rate must be prospective only. Nantahala further cites *Public Service Commission of New York* v. *F.E.R.C.*, 642 F.2d 1335 (D.C. Cir. 1980), *cert. denied*, 102 S. Ct. 360 (1981) (hereinafter *Transco*), for the proposition that the company's burden of justifying its rate increase does not extend to portions of the filing it does not seek to change, specifically the allocation of entitlements.

The parties apparently misconstrue the filed rate doctrine and the prohibition against retroactive ratemaking. Neither concept has been violated by Opinion No. 139. Docket No. ER76-828 originated with a proposed rate increase by Nantahala under its Rate Schedule PL, which governs charges to customers using electric service for resale. That proposed rate increase was set for hearing under both Sections 205 and 206 of the Federal Power Act, thus giving the Commission authority to order refunds

should it find Nantahala's rates were not just and reasonable. In Opinion No. 139 the Commission found the proposed charges were not just and reasonable. Among the reasons for our finding was that the 1971 Apportionment Agreement, which is an amendment to the NFA (Nantahala's Rate Schedule No. 1), does not afford Nantahala its fair share of NFA energy entitlements, and the rates under Rate Schedule PL are directly affected by the amount of entitlements received by Nantahala. The Commission specifically stated that it was not reforming the 1971 Apportionment Agreement. Instead, the Opinion sets rates for Nantahala as though it had received its fair share of entitlements. The Commission properly acted under Section 205 of the Federal Power Act in setting just and reasonable rates.

The rule against retroactive ratemaking is that a utility may not set rates to recoup past losses, nor may a Commission prescribe rates on that principle.[3] Utility refunds for past excessive rates are thus barred, as is the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate.[4] There has been no retroactive substitution of rates in Docket No. ER76-828. By order issued August 31, 1976, 56 FPC 2937, we suspended Nantahala's rates in that docket until October 1, 1976. Opinion No. 139 does not affect rates prior to that date. It deals only with the time period covered by the revised Rate Schedule PL.

The filed rate doctrine is equally clear. A company can claim no rate as a legal right that is other than the filed rate, whether fixed or merely accepted by the Commission.[5] The considerations underlying the doctrine "are preservation of the

---

[3]*Nader* v *F.C.C.*, 520 F.2d 182, 202 (D.C. Cir. 1975); *City of Piqua* v. *F.E.R.C., 610 F.2d 950, 954 (D.C. Cir. 1979); Public Service Co. of N.H.* v. *F.E.R.C., 600 F.2d 944, 957 (D.C. Cir. 1979).*

[4]*City of Piqua, supra; Public Service Co. of N.H., supra.*

[5]*Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251 (1951).

agency's primary jurisdiction over reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant."[6] Nantahala claims no more than the filed rate in Docket No. ER76-828, and Opinion No. 139 gives Nantahala no more than the filed rate. The Opinion determines that the filed rate does not constitute a just and reasonable rate.

The Commission, in acting within its powers under Section 205 of the Federal Power Act, is not limited to setting new rates on a prospective basis only. It is true that we would be prohibited from relieving a company of an improvident contract unless we made a Section 206 finding that rates under the contract were so low as to adversely affect the public interest.[7] In this case, however, we have not modified Nantahala's contracts. Instead, we have set just and reasonable rates under our powers under Section 205. As to Nantahala's citation to the *Transco* case, *supra,* that case dealt with the Commission's attempt to alter a company's historical rate design which did not affect the overall level of rates, *i.e.,* Transco was merely a stakeholder and it was the individual customer groups who would be affected by the rate design. In contrast, this case involves the prudence of the costs incurred by Nantahala. Nantahala's entire rate filing was suspended and made subject to refund under Section 205, and the company bears the burden of proving all elements of the filing which will affect overall costs and resulting rates.[8]

---

[6]*City of Cleveland* v. *F.P.C.*, 525 F.2d 845, 854 (D.C. Cir. 1976).

[7]*Sierra Pacific Power Co.* v. *F.P.C.*, 350 U.S. 348, 355 (1956); *Pacific Gas and Electric Co.* v. *F.P.C.*, 267 F.2d 165, 166 (D.C. Cir. 1959).

[8]*North Penn Gas Co.*, 18 FERC ¶ 61,275 (1982); *Connecticut Yankee Atomic Power Co.*, Opinion No. 102, 13 FERC ¶ 61,154 (1980). See also *Cities of Batavia* v. *F.E.R.C.*, Nos. 80-1072 and 81-1270 (D.C. Circuit February 9, 1982) at 23, in which the court stated that it does not read the *Transco* decision "as precluding the Commission from reviewing a revised rate completely to assure that all of its parts—old and new—operate in tandem to insure a 'just and reasonable' result . . ."

One further point should be made. Absent compelling reasons to the contrary, we think it inappropriate to require refunds which would bring the company's rate below the superseded rate. No such compelling reasons have been shown here. We therefore conclude that the total refunds ordered herein shall not exceed the difference between the amounts that would have been collected under the superseded rate schedules and the amounts that were collected pursuant to the rate schedules at issue herein. In other words, the superseded rate shall act as a floor for refund purposes. Otherwise, the compliance rates shall be consistent with Opinion No. 139.

* * *

The Commission orders:

(A) The applications for rehearing of Opinion No. 139, filed June 11 and June 14, 1982 in the above dockets, are denied.

(B) The stay of the effectiveness of Opinion No. 139, granted by our order issued July 9, 1982, is hereby lifted. Nantahala shall make appropriate refunds with interest, in accordance with the terms of our opinions in these dockets.

APPENDIX K

Notices Of Appeal

No. 227A83 TENTH DISTRICT

SUPREME COURT OF NORTH CAROLINA

STATE OF NORTH CAROLINA, ex rel. Utilities Commission; RUFUS L. EDMISTEN, ATTORNEY GENERAL; PUBLIC STAFF, HENRY J. TRUETT; CHEROKEE, GRAHAM and JACKSON COUNTIES; TOWNS OF ANDREWS, BRYSON CITY, DILLSBORO, ROBBINSVILLE, and SYLVA; and THE TRIBAL COUNCIL OF THE EASTERN BAND OF CHEROKEE INDIANS, Appellees, v. NANTAHALA POWER AND LIGHT COMPANY; ALUMINUM COMPANY OF AMERICA; and TAPOCO, INC., Appellants.	FROM THE NORTH CAROLINA SUPREME COURT CASE NO. 227A83—Utilities Decided July 3, 1985

NOTICE OF APPEAL TO THE UNITED STATES SUPREME COURT BY NANTAHALA POWER AND LIGHT COMPANY [FILED JULY 23, 1985]

TO THE HONORABLE SUPREME COURT OF THE UNITED STATES

Applicant Nantahala Power and Light Company (hereinafter Nantahala) hereby appeals to the United States Supreme Court from the judgment of the North Carolina Supreme Court in Case No. 227A83—Utilities, issued July 3, 1985, affirming the North

Carolina Utilities Commission order issued August 17, 1982 in Docket No. E-13, Sub 29 (Remanded). The judgment of the North Carolina Supreme Court affirmed the North Carolina Utilities Commission's order reducing Nantahala's retail rates and requiring Nantahala to make refunds to its retail customers.

Nantahala gives notice that it appeals from the entire above described judgment of the North Carolina Supreme Court on the ground that the North Carolina Supreme Court upheld the validity of a North Carolina statute, as that term has been interpreted under 28 U.S.C. §1257(2) and its predecessors, which statute had been challenged on the ground of its being repugnant to the Constitution and laws of the United States. Nantahala's notice of appeal is taken pursuant to 28 U.S.C. §1257(2).

NANTAHALA POWER AND LIGHT COMPANY

By____________________

Counsel

OF COUNSEL:

Edward S. Finley, Jr.
William D. Johnson
HUNTON & WILLIAMS
Post Office Box 109
Raleigh, North Carolina 27602
(919) 828-9371

No. 227A83 TENTH DISTRICT

SUPREME COURT OF NORTH CAROLINA

STATE OF NORTH CAROLINA, ex rel. Utilities Commission; RUFUS L. EDMISTEN, Attorney General; PUBLIC STAFF; HENRY J. TRUETT; CHEROKEE, GRAHAM and JACKSON COUNTIES; TOWNS OF ANDREWS, BRYSON CITY, DILLSBORO, ROBBINSVILLE and SYLVA; MURIEL MANEY; SWAIN COUNTY BOARD OF COUNTY COMMISSIONERS; DEROL CRISP; and THE TRIBAL COUNCIL OF THE EASTERN BAND OF CHEROKEE INDIANS, Appellees, v. NANTAHALA POWER AND LIGHT COMPANY; ALUMINUM COMPANY OF AMERICA; and TAPOCO, INC., Appellants.	COURT OF APPEALS (Wake County) No. 8210UC1034 UTILITIES COMMISSION Docket No. E-13, Sub 29

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES [FILED JULY 23, 1985]

Notice is hereby given that Aluminum Company of America appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of North Carolina entered herein on July 3, 1985. This appeal is taken pursuant to 28 U.S.C. §1257(2).

Respectfully submitted this 23rd day of July, 1985.

LEBOEUF, LAMB, LEIBY & MACRAE

By: ______________________

Ronald D. Jones

336 Fayetteville Street
P.O. Box 750
Raleigh, North Carolina 27602
(919) 833-9789

No. 227A83 TENTH DISTRICT

SUPREME COURT OF NORTH CAROLINA

STATE OF NORTH CAROLINA, ex rel. Utilities Commission; RUFUS L. EDMISTEN, Attorney General; PUBLIC STAFF; HENRY J. TRUETT; CHEROKEE, GRAHAM and JACKSON COUNTIES; TOWNS OF ANDREWS, BRYSON CITY, DILLSBORO, ROBBINSVILLE and SYLVA; SWAIN COUNTY BOARD OF COUNTY COMMISSIONERS; DEROL CRISP; and THE TRIBAL COUNCIL OF THE EASTERN BAND OF CHEROKEE INDIANS, Appellees, v. NANTAHALA POWER AND LIGHT COMPANY; ALUMINUM COMPANY OF AMERICA; and TAPOCO, INC., Appellants.	UTILITIES COMMISSION Docket No. E-13, Sub 29

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES [FILED SEPTEMBER 23, 1985]

Notice is hereby given that Tapoco, Inc. appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of North Carolina entered herein on July 3, 1985. This appeal is taken pursuant to 28 U.S.C. §1257(2).

Respectfully submitted this 23rd day of September, 1985.

LEBOEUF, LAMB, LEIBY & MACRAE

____

David R. Poe

336 Fayetteville Street
P.O. Box 750
Raleigh, North Carolina 27602
(919) 833-9789

[THIS PAGE INTENTIONALLY LEFT BLANK]

APPENDIX L

Opinion Of The Eighth Circuit In *Middle South Energy, Inc. v. Arkansas Public Service Commission,* Nos. 84-2409, 84-2410, and 84-2480 (filed Aug. 23, 1985)

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

No. 84-2409
No. 84-2410
No. 84-2480

Middle South Energy, Inc., and Arkansas Power and Light Company,
Appellees,

v.

Arkansas Public Service Commission; Robert E. Johnston, Commissioner; Patricia S. Qualls, Commissioner; and James W. Daniel, Commissioner; Attorney General of Arkansas; and Ratepayers Fight Back,
Appellants.

Appeal from the United States District Court for the Eastern District of Arkansas.

Submitted: April 8, 1985
Filed: August 23, 1985

Before ROSS and JOHN R. GIBSON, Circuit Judges, and MEREDITH,* Senior District Judge.

JOHN R. GIBSON, Circuit Judge.

*The HONORABLE JAMES H. MEREDITH, Senior United States District Judge for the Eastern District of Missouri, sitting by designation.

The issues before us involve a judgment of the district court[1] enjoining the Arkansas Public Service Commission from continuing proceedings to determine whether it should declare void *ab initio* certain contracts entered into by Arkansas Power and Light Company with respect to the purchase of power from, or payment for construction of, a nuclear power plant located in Mississippi. The Arkansas Public Service Commission, the Attorney General of Arkansas, and a consumer group called Ratepayers Fight Back argue that the district court erred in finding that the Federal Energy Regulatory Commission has exclusive jurisdiction over the contracts that were the subject of the APSC's proceedings. They further argue that the district court lacked subject matter jurisdiction, that the litigation was not ripe, and that the court abused its discretion by failing to abstain pending the outcome of the state agency proceedings and by granting overbroad relief. We have carefully considered these arguments, and because we believe that the actions threatened by the APSC would burden interstate commerce, we affirm the judgment of the district court.

The Arkansas Power and Light Company, together with the Louisiana Power and Light Company, the Mississippi Power and Light Company, and New Orleans Public Service, Inc., are wholly-owned operating subsidiaries of Middle South Utilities, Inc. The operating companies provide electric service to wholesale and retail consumers in Arkansas, Louisiana, Mississippi, and Missouri, with an aggregate consumer population of approximately five million people. Planning and operation of the electric generation and transmission facilities needed to meet the demands of the MSU system are performed according to systems agreements. "Transmission and generation functions are so coordinated and integrated as to permit an instantaneous transfer of electrical power to any part of Middle South's transmission network." *Arkansas Power & Light Co. v. Federal Power Commission,* 368

[1]The Honorable Henry Woods, United States District Judge for the Eastern District of Arkansas.

F.2d 376, 378 (8th Cir. 1966). Because the need was seen in the early 1970's to develop additional power generating facilities, Middle South Energy, Inc., also a wholly-owned MSU subsidiary, was created in 1974 to finance, construct, and operate a two-unit nuclear generating plant to be located in Port Gibson, Mississippi and known as the Grand Gulf Nuclear Electric Station.[2] The creation of MSE was necessary because none of the four operating subsidiaries had sufficient resources to finance and construct the nuclear generating plant.

This case involves contracts entered into with respect to the financing and construction of the plant, as well as agreements made concerning the sale of the power to be generated. MSE has financed the three billion dollar cost of the first unit by selling common stock to MSU,[3] borrowing from commercial banks, and issuing first mortgage[4] and pollution control bonds.[5]

[2]Grand Gulf Unit No. 1 was scheduled to commence commercial operation on July 1, 1985, while the construction of Grand Gulf Unit No. 2 has been suspended.

[3]MSU is registered under and subject to Securities and Exchange Commission authority by the Public Utility Holding Company Act of 1935. 15 U.S.C. §§ 79 to 79z-6 (1982). These stock sales received SEC approval. Middle South Utilities, SEC Public Utility Holding Co. Act Rel. No. 23,579 (Jan. 23, 1985). In opposing approval of the most recent stock sale, APSC urged that the SEC withhold authorization until AP&L could show compliance with Arkansas law. The SEC rejected this argument, but assured the APSC that the federal securities authorization did not "supersede requirements of state laws as they may eventually be established in respect to AP&L's commitments in the financing of the Grand Gulf project." *Id.* at 7.

[4]This transaction was approved by the SEC. Middle South Energy, SEC Public Utility Holding Co. Act Rel. No. 23,526 (Dec. 12, 1984).

[5]This transaction was approved by the SEC. Middle South Energy, SEC Public Utility Holding Co. Act Rel. No. 23,495 (Nov. 23, 1984). APSC urged the SEC to withhold approval on the ground that AP&L had not complied with state law. The SEC declined, but noted that the SEC "does not resolve disputed issues of state law and the order in this case does not prejudice the Arkansas Commission, which may assert its jurisdiction under whatever procedures the state laws permit." *Id.* at 2 (footnote omitted).

In 1974, through a document called the Availability Agreement, MSE obtained from each of the MSU operating companies their commitment to purchase power from the Grand Gulf project. The operating companies agreed to pay MSE, beginning on specified dates, amounts needed for MSE to meet its operating expenses, whether or not the two units of the project were then operating. Payments would be credited to the cost of their future power purchases from MSE. The Availability Agreement has been essential to the financing of the project.[6] Pursuant to a series of ten agreements entered into between 1977 and 1984, MSE has assigned its rights under the Availability Agreement to secure indebtedness in excess of $2.5 billion.[7]

The Availability Agreement initially provided that the share of Grand Gulf power taken by the operating companies would vary relative to their respective needs. In June 1981, the Availability Agreement was amended[8] to fix the allocations of power in these percentages:[9] AP&L—17.1%; LP&L—26.9%; MP&L—31.3%; NOPSI—24.7%.

[6]The financing aspects of the original Availability Agreement were approved by the SEC. Middle South Utilities, SEC Public Utility Holding Co. Act Rel. No. 18,437 (June 4, 1974). APSC did not intervene in this proceeding. Its attacks on the agreement in collateral proceedings before the SEC have been rejected. *See supra* notes 3 & 5.

[7]A number of agreements were executed in which the operating companies agreed that in case of default by MSE they would make payments due under the Availability Agreement directly to the banks. In return, the lenders agreed that, should some regulatory agency prohibit the operating companies from making payments under the Availability Agreement, the lenders would make unsecured advances to MSE equal to the amounts it would have received under the Availability Agreement.

[8]The Amendment was approved by the SEC. Middle South Energy, Public Utilities Holding Co. Act Rel. No. 22,098 (June 22, 1981).

[9]South Mississippi Electric Power Association, which is not a subsidiary of MSU, owns 10% of the Grand Gulf project. The allocation figures pertain to the 90% share owned by MSE.

On July 28, 1981, MSE and the operating companies entered into a Reallocation Agreement, under which the operating companies agreed to purchase power in the following percentages: AP&L—0%; LP&L—38.57%; MP&L—31.63%; NOPSI—29.80%.[10] In June 1982, MSE and the operating companies entered into an agreement, the Unit Power Sales Agreement, which required each operating company to purchase the shares of power specified in the Reallocation Agreement. AP&L signed the UPSA but, in accordance with the terms of the Reallocation Agreement, did not agree to purchase any power from the project. The UPSA was filed with the Federal Energy Regulatory Commission for approval as a wholesale power sales agreement.

In February 1984, a FERC administrative law judge rejected the allocation in the UPSA and obligated the operating companies to purchase power from Unit No. 1 as follows: AP&L—36%; LP&L—14%; MP&L—33%; NOPSI—17%. The ALJ reasoned that:

> [T]he evidence of Middle South's witnesses is overwhelming that the Middle South system is a single integrated and coordinated electric system operating in Louisiana, Mississippi, Arkansas and Missouri. Planning, construction, and operations are conducted for the system as a whole. Loads on the system are met by centrally dispatching the most economical mix of generators wherever located in the system. Middle South Utilities, Inc. owns the stock of the operating utilities as well as the stock of MSS and MSE. When difficult system decisions have to be made, such as deciding the allocation of Grand Gulf, it is the Board of Directors of Middle South Utilities, Inc., that ultimately makes the decision, not an individual subsidiary company or a group of subsidiaries.
>
> The Grand Gulf project was initiated in the 1970's to meet the then projected demand on the Middle South system by the end of that decade and not just the load of any Middle

[10]This agreement was approved by the SEC. Middle South Energy, Public Utility Holding Co. Act Rel. No. 22,280 (Nov. 18, 1981).

> South operating company or companies. Constructing generation to meet system load was true of every unit constructed on the Middle South system.
>
> Under these circumstances the costs of Grand Gulf capacity and energy should be shared equitably by MSU's operating companies and their customers.

Middle South Energy, 26 F.E.R.C. ¶ 63,044, at 65,106 (1984), *aff'd*, 31 F.E.R.C. ¶ 61,305 (1985). The APSC had actively intervened in the proceedings before FERC. It had contended that FERC had no jurisdiction to obligate AP&L to take a share of Grand Gulf and that Arkansas neither wanted or needed the relatively high-cost power from the project. These arguments were rejected.

Approximately one month later, the APSC issued two orders instituting formal inquiries into AP&L's role in the Grand Gulf project. Predicting that Grand Gulf would result in "dramatic [rate] increases" which would place an "intolerable burden" on AP&L's customers and have a "crippling effect" on the Arkansas economy, *Arkansas Power & Light Co.*, Ark. Pub. Serv. Comm'n Docket No. 84-041-OII, at 1 (Mar. 12, 1984), the APSC ultimately sought to "protect the interests of the residential, business, and industrial customers of AP&L and preserve the viability of the economy of the State of Arkansas." *Arkansas Power & Light Co.*, Ark. Pub. Serv. Comm'n Docket No. 84-040-OII, at 2 (Mar. 12, 1984).

On August 1, 1984, the APSC ordered AP&L to appear and "show cause why all contracts and agreements made by it with respect to any obligations to purchase power from or to pay for construction and operation costs of the Grand Gulf Project should not be held to be void *ab initio* as a matter of law." *Arkansas Power & Light Co.*, Ark. Pub. Serv. Comm'n Docket No. 84-190-U, at 6 (Aug. 1, 1984). The APSC had already concluded that thirty-six such agreements constituted prima facie violations of

Arkansas law requiring APSC approval of certain transactions by public utilities. *Id.; see* Ark. Stat. Ann. § 73-253(a)(3) (1979 Repl.) (utility must have APSC approval to "sell, acquire, lease or rent any public utility plant or property constituting an operating unit or system"); *id.* § 73-255 (Supp. 1983) (utility must have APSC approval to "issue stocks, bonds, notes or other evidence of indebtedness payable at periods of more than thirty-six (36) months"). After AP&L's motion to dismiss the show cause order for lack of jurisdiction was denied, MSE filed suit in the district court to temporarily and permanently enjoin the proceedings before the APSC. AP&L intervened as a plaintiff, while the Arkansas Attorney General and Ratepayers Fight Back intervened as defendants. A hearing was held on the consolidated issues of preliminary and permanent relief. The district court found that the APSC's actions were preempted by the Federal Power Act, 16 U.S.C. §§ 824–824K (1982), and permanently enjoined APSC from conducting further proceedings on the show cause order. Regarding the need for equitable relief, the court found:

> MSE must raise an additional several billion dollars in the next few years to pay construction and financing costs. The ability to raise these funds is dependent on the enforceability of the threatened agreements. If the actions of the APSC are not enjoined, the cost of capital to MSE will be raised to the point that the Project is jeopardized, and the ability of MSE to provide its multi-state wholesale customers with power will be irreparably impaired.

Middle South Energy, Inc. v. Arkansas Public Service Commission, No. LR-C-84-778, slip op. at 5 (E.D. Ark. Sept. 14, 1984).[11]

The APSC, the Arkansas Attorney General, and Ratepayers filed an appeal with this court.[12] After the case was argued, FERC

[11]The SEC noted recently that delaying commercial operation of the reactor would increase costs by about $28 million per month, primarily in finance charges. Middle South Utilities, Public Utility Holding Co. Act Rel. No. 23,579 at 9 (Jan. 23, 1985).

[12]Arkansas Electric Energy Consumers and Reynolds Metals Company filed an amicus curiae brief, as did the Metropolitan Life Insurance Company and other holders of MSE's first mortgage bonds.

affirmed the order of the ALJ allocating AP&L 36% of the Grand Gulf capacity. *Middle South Energy,* 31 F.E.R.C. ¶ 61,305 (1985).

I.

As an initial matter, amicus curiae on behalf of the APSC[13] asserts that MSE's suit does not "aris[e] under the Constitution [or] laws *** of the United States" as required to invoke federal question jurisdiction under 28 U.S.C. § 1331 (1982) because, pursuant to the "well-pleaded complaint" rule, the federal question must be raised necessarily as an element of the plaintiff's entitlement to relief and cannot merely be a response to an anticipated defense. *See generally Franchise Tax Board v. Construction Laborers Vacation Trust,* 463 U.S. 1, 7–12 (1983) (citing older cases). Specifically, amicus curiae argues that jurisdiction is lacking because MSE's preemption claim is merely a defense to the state administrative action. *See id.* at 15–16 (discussing *Skelly Oil Co. v. Phillips Petroleum Co.,* 339 U.S. 667 (1950)). This argument ignores the recognition by the Supreme Court that "a claim of federal preemption does not always arise as a defense to a coercive action." *Franchise Tax,* 463 U.S. at 12 n.12; *see Aluminum Co. of America v. Utilities Commission,* 713 F.2d 1024, 1028 (4th Cir. 1983), *cert. denied,* 104 S. Ct. 1326 (1984). The "not a defense to a state action" rule is premised on the determination that the declaratory judgment act, 28 U.S.C. § 2201 (1982), is merely procedural and that Congress thereby did not enlarge the subject matter jurisdiction of federal courts. *Skelly Oil Co. v. Phillips Petroleum Co.,* 339 U.S. 667, 671–72 (1950). This concern is not implicated when the declaratory plaintiff has independent grounds for federal relief such as an injunction. Note, *Federal Jurisdiction over Declaratory Suits*

[13]We consider this issue, though not raised by a party, since subject matter jurisdiction cannot be waived or conferred by consent. *Insurance Corp. of Ireland v. Compagnie des Bauxites de Guinea,* 456 U.S. 694, 702 (1982); *United States ex rel. Burnette v. Driving Hawk,* 587 F.2d 23, 24 (8th Cir. 1978).

Challenging State Action, 79 Colum. L. Rev. 983, 1001 (1979).[14] Thus, the district court had subject matter jurisdiction pursuant to MSE's complaint, which on its face properly raises the federal question of whether the state proceeding should be enjoined on preemption[15] grounds.[16] *Shaw v. Delta Air Lines,* 463 U.S. 85, 96 n.14 (1983).

[14]To deny access to federal court when, regardless of the existence of procedures for declaratory relief, an injunction would otherwise have been available would contract the jurisdiction of the federal courts. Note, *supra,* at 1001. Cases that appear to have taken this route have generally relied on the Supreme Court decision of *Public Serv. Comm'n v. Wycoff Co.,* 344 U.S. 237 (1952), which actually turned on the failure of the plaintiff to establish a ripe controversy or to identify what right it was asking the court to declare. *Id.* at 244–46; *see Franchise Tax,* 463 U.S. at 16 n.14. Furthermore, the widely quoted *Wycoff* dictum suggesting that even if the controversy had been ripe, federal subject matter jurisdiction would have been lacking, is again couched solely in terms of declaratory relief, the Court having determined that the plaintiff had abandoned its request for an injunction because of the absence of proof of the threatened injury necessary to support that form of relief. 344 U.S. at 241. The Supreme Court itself has never interpreted *Wycoff,* as some courts of appeals have, to hold that subject matter jurisdiction does not exist any time a federal claim can be litigated as a state defense. *Illinois v. General Elec. Co.,* 683 F.2d 206, 211 (7th Cir. 1982), *cert. denied,* 461 U.S. 913 (1983); *Braniff Int'l v. Florida Pub. Serv. Comm'n,* 576 F.2d 1100, 1104 (5th Cir. 1978). Concerns with the timing of adjudication need not distort analysis of subject matter jurisdiction but instead can be—and more appropriately are—handled through the discretion of courts in matters involving equitable relief and through doctrines such as exhaustion of administrative remedies and abstention. Note, *supra,* at 1001.

[15]It makes no difference to subject matter jurisdiction that we ultimately choose not to decide this case on preemption grounds. Furthermore, the operation of the commerce clause in limiting state authority is sufficiently similar to preemption that we believe the same jurisdictional analysis applies.

[16]There are no Eighth Circuit decisions to the contrary. Despite the representations of amicus curiae, three of the cases it cites stand only for the proposition that a preemption claim does not raise a federal question under section 1331 when, ***absent the availability of the declaratory judgment procedure,*** it would have arisen only as a defense to a state ac-

(Footnote continued on next page.)

Appellants nevertheless argue that jurisdiction is lacking because there will be no "ripe" case or controversy until the APSC reaches some determination as to the validity of the contracts and the effects of that determination are felt by MSE. *See Abbott Laboratories v. Gardner,* 387 U.S. 136, 148–49 (1967). This argument again ignores the true nature of the relief sought. MSE challenges not the state's ultimate substantive decision but its authority to even conduct the contemplated proceeding. It can hardly be doubted that a controversy sufficiently concrete for judicial review exists when the proceeding sought to be enjoined is already in progress.

II.

The district court's decision on preemption grounds was based on the Federal Power Act. Congress's purpose in enacting the Act was to regulate "the transmission of electric energy in interstate commerce and *** the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(b) (1982). To accomplish this goal, Congress gave FERC the power to make "just and reasonable" any public utility "rule, regulation, practice *or contract*

(Footnote continued from preceding page.)

tion. Neither the language nor context of these cases extends this interpretation of the well-pleaded complaint rule to foreclose *injunctions* sought on preemption grounds. *E.g., First Fed. Sav. & Loan Ass'n v. Anderson,* 681 F.2d 528 (8th Cir. 1982) (declaratory judgment only sought; no pending state proceeding to enjoin); *Lawrence County v. South Dakota,* 668 F.2d 27 (8th Cir. 1982) (same); *First Nat'l Bank v. Aberdeen Nat'l Bank,* 627 F.2d 843 (8th Cir. 1980) (en banc) (removal to federal court improper when based on ground that preemption would be raised as a defense to state tort action). The one case cited by amicus curiae in which we did find subject matter jurisdiction lacking despite a request for an injunction is distinguishable in that the panel expressly found the preemption claim there to be only in the nature of a defense to the state administrative proceeding. *Home Fed. Sav. & Loan Ass'n v. Insurance Dep't,* 571 F.2d 423, 427 (8th Cir. 1978). Since MSE is seeking affirmative relief from the APSC's attempts to even inquire into certain affairs relating to its business, we need not decide if the characterization of the preemption claim in *Home Federal* remains viable in light of *Shaw.*

affecting [a] rate, charge, or classification [that] is unjust, unreasonable, unduly discriminatory or preferential." *Id.* § 824e(a) (emphasis added).

The district court held that the Availability Agreement and its amendments were "agreements for the purchase of wholesale power in interstate commerce or are so integrally related to such purchases that they are subject to the exclusive jurisdiction of the FERC." Slip op. at 7. The other agreements subject to the APSC order were found to be "essential to the interstate wholesale sale of power and therefore *** not subject to state jurisdiction." *Id.* We read the district court's order as finding preemption on the ground that the threatened actions of the APSC would block the accomplishment of the purpose behind the Federal Power Act. *See Hines v. Davidowitz,* 312 U.S. 52, 67 (1941).

Essentially, the APSC is trying to secure for Arkansas the zero allocation embodied in the UPSA. Such a result would be contrary to the 36% allocation recently approved by FERC in regulating the wholesale aspects of the Grand Gulf project. Thus, a strong argument can be made that the APSC's powers have been preempted by the Federal Power Act. The appellants, on the other hand, urge that we examine the APSC's powers in light of other federal legislation, the Public Utility Holding Company Act of 1935. This law, they argue, expressly reserves to the states some jurisdiction to regulate the securities dealings of utility holding companies and their subsidiaries. *See* 15 U.S.C. §§ 79f(b), 79g(g), 79u (1982); *infra* at 17-20; *supra* notes 3 & 5.

The district court's order did not squarely deal with the argument now made by appellants. We are not convinced that the district court improperly based its decision on preemption grounds. Nevertheless, we choose not to address the difficult question of whether the authority denied the states under the Federal Power Act may be granted to them by the Holding Company Act, because the case can be disposed of under well-settled commerce

clause principles. *See New England Power Co. v. New Hampshire,* 455 U.S. 331, 344 n.10 (1983) (deferring resolution of preemption issues in favor of commerce grounds).

III.

The commerce clause grants Congress the power to regulate commerce among the states. U.S. Const., art. I, § 8, cl. 3. It has long been recognized as implying limits on the powers of the states to erect barriers against interstate trade. *South-Central Timber Development v. Wunnicke,* 104 S. Ct. 2237, 2240 (1984); *see Cooley v. Board of Wardens,* 53 U.S. (12 How.) 299, 317-18 (1852). Absent conflicting federal legislation, the states may exercise police power over matters of legitimate local concern even though such regulation may affect interstate commerce. *Philadelphia v. New Jersey,* 437 U.S. 617, 623-24 (1978); *Raymond Motor Transportation v. Rice,* 434 U.S. 429, 440 (1978). Incidental burdens on interstate commerce may be unavoidable when a state legislates to protect its citizens. *Philadelphia* v. *New Jersey,* 437 U.S. at 623-24. Nevertheless, the safeguarding of local interests must ultimately yield to the principle that "one state in its dealings may not place itself in a position of economic isolation." *Baldwin v. G.A.F. Seeling, Inc.,* 294 U.S. 511, 527 (1935).

"[T]he regulation of utilities is one of the most important of the functions traditionally associated with the police power of the states." *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission,* 461 U.S. 375, 377 (1983). "Need for new power facilities, their economic feasibility, and rates and services, are areas that have been characteristically governed by the States." *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission,* 461 U.S. 190, 205 (1983); *see also Central Hudson Gas & Electric Corp. v. Public Service Commission,* 447 U.S. 557, 569 (1980) ("The state's con-

cern that rates be fair and efficient represents a clear and substantial governmental interest."). At the same time, however, the "production and transmission of energy is an activity particularly likely to affect more than one state, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests." *Arkansas Electric*, 461 U.S. at 377. The dispositive issue here is whether the APSC's desire to protect Arkansas' interest has resulted in an impermissible burden on interstate commerce.

IV.

The Attorney General argues that since the APSC has only issued a show cause order, and not actually voided the contracts in issue, there is no significant burden on interstate commerce. The APSC's position in the administrative proceedings surrounding Grand Gulf, however, leaves little doubt that APSC intends to substantially reduce or eliminate AP&L's participation in the project. The threat of enforcement presented by the show cause order is sufficient to support an injunction against further proceedings.

On March 12, 1984, the APSC issued two orders instituting investigations. The first, retrospective in nature, referred to developments in FERC proceedings that "portend[ed] catastrophically enormous rates increases" for AP&L customers. *Arkansas Power & Light Co.*, Ark. Pub. Serv. Comm'n Docket No. 84-040-0II, at 1 (Mar. 12, 1984). The second order, prospective in nature, was to

> look forward to ascertain what the ratepayers of AP&L, AP&L itself, the Commission, the Governor, and the General Assembly may do to circumvent or deflect the economic harm that looms over the State from the imminent prospect of being mandated by a federal agency to pay for a power generating plant that is possibly neither needed or wanted by anyone in Arkansas, * * * and that would, if forced upon the State, potentially result in such immense amounts of excess generating capacity that it could neither be used or sold by AP&L.

Arkansas Power & Light Co., Ark. Pub. Serv. Comm'n Docket No. 84-041-0II, at 2 (Mar. 12, 1984); *see supra* at 6.

Nearly five months later, APSC issued the show cause order that gave rise to this lawsuit. It listed thirty-six agreements relating to the Grand Gulf project, and stated: "The construction of the Grand Gulf Project was and is dependent on the[se] agreements." *Arkansas Power & Light Co.*, Ark. Pub. Serv. Comm'n Docket No. 84-190-U, at 5 (Aug. 1, 1984). The APSC stated that its approval, required by Arkansas law, had not been given the agreements and that some or all were "prima facie violations of Arkansas law." *Id.* at 6. AP&L was ordered to appear and show cause "why all contracts and agreements made by it with respect to any obligations to purchase power from or to pay for construction and operation costs of the Grand Gulf Project should not be held void *ab initio* as a matter of law." *Id.* The APSC later denied AP&L's motion to dismiss the show cause order for lack of jurisdiction based on FERC's exclusive jurisdiction over the agreements. *Arkansas Power & Light Co.*, Ark. Pub. Serv. Comm'n Docket No. 84-190-U (Aug. 31, 1984).

The APSC argued vigorously before both FERC and the SEC for a reduction or elimination of AP&L's role in Grand Gulf. In an SEC proceeding to authorize the sale of common stock by MSE, the APSC asked the Commission to consider the "discontinuance or moth-balling" of the Grand Gulf project. Middle South Utilities, SEC Public Utility Holding Co. Act Rel. No. 23,579 at 9 (Jan. 23, 1985). In litigation before FERC, the APSC sought to avoid the allocation of any Grand Gulf power to Arkansas, claiming that the state does not need and cannot economically use the power. *Middle South Energy*, 26 F.E.R.C. ¶ 63,044 (1984), *aff'd*, 31 F.E.R.C. ¶ 61,305 (1985).[17]

[17]Further, after this lawsuit was filed, the following account appeared in the press: "[A]n attorney representing the Arkansas utility commis-

(Footnote continued on next page.)

The threat posed by the show cause order is sufficient to warrant the injunction. In *Pennsylvania v. West Virginia,* 262 U.S. 553 (1923), two states brought suits to enjoin West Virginia from enforcing legislation that would have reduced out-of-state delivery of West Virginia natural gas. The Court rejected the argument that the suits were premature, finding that the gas curtailment was "presently threatened and likely to be productive of great injury." *Id.* at 591. In proceeding to consider the merits of the commerce clause issue, the Court observed: "One does not have to await the consummation of threatened injury to obtain preventive relief. If the injury is certainly impending that is enough." *Id.* at 593; *see also Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission,* 461 U.S. 190, 201 (1983) (decision on preemption of state nuclear waste disposal law should not be delayed because postponement "would likely work substantial hardship on the utilities").

The mere possibility that a state's interpretation of its law may avoid the necessity for an injunction does not preclude federal review. In *City of Chicago v. Atchison, Topeka & Santa Fe Railway,* 357 U.S. 77 (1958), the Court rejected an argument in a commerce clause case that a declaratory judgment should not issue because the state courts had not been given a chance to act. Among other things, the Court reasoned that: "Remission to [state court] would involve substantial delay and expense, and the chance of a result different from that reached below, on the issue of applicability, would appear to be slight." *Id.* at 84.

In this case, as in the *West Virginia* and *Pacific Gas* cases, the threatened action is likely to cause great injury, in the form of higher financing costs for MSE. Also, as in *City of Chicago,* the

(Footnote continued from preceding page.)
sion said the commission staff is confident it can defend its order against the Middle South suit. He added that "if the APSC voids AP&L's part (of Grand Gulf), the whole thing goes down the toilet." Wall St. J., Sept. 6, 1984, at 7, col. 4-5 (Plaintiff's Ex. 10).

chance of a state adjudication obviating the commerce clause issue is remote. Thus, we conclude that a commerce clause violation can be found notwithstanding that the APSC has not actually voided the agreements. *Cf. Northern Natural Gas Co. v. State Corporation Commission,* 372 U.S. 84, 92 (1963) ("[A]lthough collision between the state and federal regulation may not be an inevitable consequence, there lurks such imminent possibility of collision in orders purposely directed at interstate wholesale purchasers that the orders must be declared a nullity."); *Public Service Commission v. Wycoff Co.,* 344 U.S. 237, 245 (1952) (Court refused to allow suit for declaratory relief against state commission where no "risk of suffering penalty, liability or prosecution was shown"); *Natural Gas Pipeline Co. v. Slattery,* 302 U.S. 300, 308-09 (1937) (declining to find a commerce clause violation in utilities commission merely seeking records, the Court noted that no action based on discovered information was alleged and that it "will be time enough to challenge such action of the commission when it is taken or *at least threatened*") (emphasis added) (citations omitted).

V.

We next consider appellants' argument that Congress has authorized any unconstitutional effect that the APSC's actions may have on interstate commerce. Congress may confer upon the states the ability that they would otherwise not enjoy to restrict the flow of interstate commerce. *Lewis v. BT Investment Managers,* 447 U.S. 27, 44 (1980); *Southern Pacific Co. v. Arizona,* 325 U.S. 761, 769 (1945). "But when Congress has not 'expressly stated its intent and policy' to sustain state legislation from attack under the Commerce Clause, we have no authority to rewrite its legislation based on mere speculation as to what Congress 'probably had in mind.' " *New England Power Co. v. New Hampshire,* 455 U.S. 331, 343 (1982) (quoting *Prudential Insurance Co. v. Benjamin,* 328 U.S. 408, 427 (1946)); *United States v. Public Utilities Commission,* 345 U.S. 295, 319 (1953) (Jackson, J.,

concurring)). Rather, "for a state regulation to be removed from the reach of the dormant commerce clause, congressional intent must be unmistakably clear." *South-Central Timber Development v. Wunnicke,* 104 S. Ct. 2237, 2242 (1984).

Ratepayers urge that there has been an "explicit recognition by Congress of the authority of a state to regulate the securities of an electric utility operating within its borders." It is true that the Public Utility Holding Company Act of 1935 (HCA), 15 U.S.C. §§ 79 to 79z-6 (1982), expressly reserves some regulatory powers to the states. Nevertheless, the provisions that Ratepayers rely upon show no congressional purpose to insulate the APSC's activity from commerce clause scrutiny.

The HCA generally requires registered companies and their subsidiaries to file declarations with the SEC that must be approved before securities may be issued or sold. 15 U.S.C. §§ 79f, 79g. Section 79f(b) exempts from the declaration requirement securities of a subsidiary company of a registered holding company, "if the issue and sale * * * are solely for the purpose of financing the business of such subsidiary company and have been expressly authorized by the State Commission of the state in which such subsidiary company is organized and doing business." This narrow exemption obviously envisions a transaction completely different from the Grand Gulf agreements. The documents of concern to the APSC involve all the entities in the Middle South system. They implicate interstate commerce far more than the intrastate dealings between a state commission and a single subsidiary do. Thus, we find in section 79f(b) no express statement by Congress to exempt the APSC's activity from the commerce clause.

A related provision, section 79g(g), provides for state input during the SEC's consideration of proposed declarations:

> If a State commission or State securities commission having jurisdiction over any of the acts enumerated in subsection

> (a) of section 79f of this title, shall inform the Commission * * * that State laws applicable to the act in question have not been complied with, the Commission shall not permit a declaration * * * to become effective until and unless the Commission is satisfied that such compliance has been effected.

Like section 79f(b), this section contains no direction from Congress concerning immunity from the commerce clause.

These conclusions are supported by *New England Power Co. v. New Hampshire,* 455 U.S. 331 (1982). In *New England Power,* the Court considered the relationship of the commerce clause to the Federal Power Act. A state utilities commission had sought to restrict the export of hydroelectric energy generated within the state. The state claimed that this action was not invalid under the commerce clause because a section in the Federal Power Act provided that the Act "shall not * * * deprive a State or State commission of its lawful authority now exercised over the exportation of hydroelectric energy which is transmitted across a State line." *Id.* § 824(b). The Court interpreted this section as doing nothing more than saving from federal preemption state authority that was otherwise lawful. It concluded that section 824(b)

> is in no sense an affirmative grant of power to the states to burden interstate commerce "in a manner which would otherwise not be permissible." * * * Nothing in the legislative history or language of the statute evinces a congressional intent "to alter the limits of state power otherwise imposed by the Commerce Clause," or to modify the earlier holdings of this Court concerning the limits of state authority to restrain interstate trade. Rather, Congress' concern was simply "to define the extent of the federal legislation's pre-emptive effect on state law."

455 U.S. at 341 (citations omitted).

The provisions of the HCA discussed above are facially similar to the statute at issue in *New England Power.* Moreover, the

Federal Power Act and the HCA have similar legislative histories. *Compare New England Power*, 455 U.S. at 341 ("The legislative history of the [Federal Power] Act * * * indicates that Congress intended only that its legislation '*tak[e] no authority from* State commissions.' ") (quoting H.R. Rep. No. 1318, 74th Cong., 1st Sess. 8 (1935)), *with Alabama Electric Cooperative v. Securities & Exchange Commission*, 353 F.2d 905, 907 (D.C. Cir. 1965) ("The purpose of the Public Utility Holding Company Act, as shown by its legislative history, was to supplement state regulation—not to supplant it."). Thus, sections 79f(b) and 79g(g) do not preclude us from finding a violation of the commerce clause here.

Ratepayers also contend that 15 U.S.C. § 79u saves any commerce clause transgression. This section provides:

> [N]or shall anything in this chapter affect the jurisdiction of any other commission, board, agency or officer of * * * any state or political subdivision of any State, over any person, security, or contract, insofar as such jurisdiction does not conflict with any provision of this chapter or any rule, regulation, or order thereunder.

In *Edgar v. Mite Corp.*, 457 U.S. 624 (1982), the Supreme Court considered whether a state tender offer statute violated the commerce clause. The federal securities laws contained a provision nearly identical to section 79u. *See* 15 U.S.C. § 78bb(a) (1982). There was no suggestion made that this savings provision could authorize state violations of the commerce clause. Rather, Justice White interpreted the statute as leaving to the courts to decide whether similar state legislation may be preempted. 457 U.S. at 631. Although Justice White did not speak for the whole Court, *Mite* supports a conclusion that section 79u does not insulate the APSC's actions from examination under the commerce clause.

VI.

We must next determine the appropriate level of scrutiny under the commerce clause. The Supreme Court has recently applied two tests to state restrictions on the flow of interstate power. In *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982), the New Hampshire Public Utilities Commission sought to restrict the export of hydroelectric energy produced within the state. The Commission's purpose was to contain the cost savings associated with this cheaper form of electrical generation to the citizens of New Hampshire. This savings was to be obtained at the expense of customers in neighboring states that had been sharing the power produced in New Hampshire. *Id.* at 335–36, 339. The Supreme Court had no trouble concluding that this sort of "protectionist regulation" was forbidden by the commerce clause. *Id.* at 339. Two reasons were cited for reaching this result. First, the utilities commission had made clear that its order was "designed to gain an economic advantage for New Hampshire citizens at the expense of * * * customers in neighboring states." *Id.* Second, the Court found indisputable that the " 'exportation ban' place[d] direct and substantial burdens on transactions in interstate commerce." *Id.* (citing *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927)). There was no discussion of balancing the state's interest against the detriment to interstate commerce.

A different analysis was used the next year in *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375 (1983). At issue was an order of the APSC asserting jurisdiction over the wholesale rates charged retail distributors by a rural power cooperative. The cooperative argued that this assertion violated the commerce clause under the test articulated in *Attleboro*, which invalidated regulations imposing a "direct" rather than "indirect" burden on interstate commerce. 461 U.S. at 390; *see Attleboro*, 273 U.S. at 90. The Court, however, decided to apply "an analysis grounded more solidly" in modern com-

merce clause cases: "Where [a] statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." 461 U.S. at 393–94 (quoting *Pike v. Bruce Church,* 397 U.S. 137, 142 (1970)). After applying this test, the Court upheld the APSC's assertion of jurisdiction.

Thus, the Court has applied a rule of presumptive invalidity to regulations designed to further economic protectionism, and a balancing test, which is far more deferential to the states, to facially neutral regulations. *See generally Baltimore Gas & Electric Co. v. Heintz,* 760 F.2d 1408, 1420–22 (4th Cir. 1985) (discussing flux in commerce clause jurisprudence). *New England Power* and *Arkansas Electric* can be harmonized under the following standard: "[W]here simple economic protectionism is effected by state legislation, a virtual *per se* rule of invalidity has been erected. In contrast, legislation that visits its effects equally upon interstate and local business may survive constitutional scrutiny if it is narrowly drawn." *Lewis v. BT Investment Managers,* 447 U.S. 27, 36 (1980). The "crucial inquiry," therefore, is whether the APSC's action "is basically a protectionist measure, or whether it can fairly be viewed as a law directed to legitimate local concerns, with effects upon interstate commerce that are only incidental." *Philadelphia v. New Jersey,* 437 U.S. 617, 624 (1978). If a discriminatory purpose is found, there is no need to engage in the *Bruce Church* balancing approach. *Bacchus Imports, Ltd. v. Dias,* 104 S. Ct. 3049, 3055 (1984).

"A finding that state legislation constitutes 'economic protectionism' may be made on the basis of either discriminatory purpose or discriminatory effect." *Id.* In this case, there is ample evidence of both. The APSC seeks to cancel the Grand Gulf agreements ostensibly because they have not received the necessary state regulatory approval. Its apparent concern, which has been made abundantly plain in its orders and its arguments before the SEC

and FERC, however, is the economic impact on Arkansas citizens caused by AP&L's participation in Grand Gulf. It seeks to deflect what it has estimated to be rate increases of more than $3.5 billion over the next ten years.[18] Given free rein, the APSC would shift this burden to the citizens of Mississippi and Louisiana, citizens who are powerless to directly influence Arkansas' internal affairs.

In *New England Power,* New Hampshire sought to contain within the state the benefits of low-cost power. Arkansas, conversely, seeks to close its borders to high-cost electricity. The effect of both actions is the same: a preference for citizens in the regulating jurisdiction gained at the expense of out-of-state customers. Nor can it be doubted that the APSC's action would constitute a direct and substantial burden on interstate commerce. The integrated nature of MSU and MSE, particularly the Grand Gulf project, represents commerce that is interstate in a most basic form. Thus, this case is controlled by *New England Power,* and the APSC must be prohibited from voiding AP&L's role in the Grand Gulf project. *See also Philadelphia v. New Jersey,* 437 U.S. at 624 ("The clearest example of [protectionist] legislation is a law that overtly blocks the flow of interstate commerce at a state's borders.").[19]

---

[18]*See Middle South Energy,* 26 F.E.R.C. at 65,097:
Because the costs of power from Grand Gulf are perceived to be much higher than the costs of power from other sources on the MSU system, it is not surprising that each of these parties supports an allocation of power which results in the lowest allocation to the MSU operating company or companies in which the party is interested, especially during the early years of operation of Grand Gulf when the costs of Grand Gulf are higher than in later years.

[19]The APSC's reliance on *Indiana & Mich. Power Co. v. Michigan,* 405 Mich. 400, 275 N.W.2d 450 (1979), is misplaced, for that case did not involve state regulation with protectionist motives. *See Michigan Gas Storage Co. v. Michigan Pub. Serv. Comm'n,* 405 Mich. 376, 275 N.W.2d 457 (1979) (companion case).

VII.

Finally, appellants assert that the district court should have used its discretion to withhold the exercise of its powers under any of several doctrines concerned with premature federal interference with state proceedings.

Under *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), for example, a federal court should abstain when the action before it involves matters of state law best left to the state alone. The very premise of this doctrine, however, is lacking when, as here, federal law or Constitution makes the proceeding or regulation at issue beyond the state's authority. *South Central Bell Telephone Co. v. Louisiana Public Service Commission*, 744 F.2d 1107, 1123–24 (5th Cir. 1984), *petition for cert. filed*, 53 U.S.L.W. 3449 (U.S. Nov. 30, 1984) (No. 84-870). There is no concern with protecting a legitimate state regulatory scheme, *Baggett v. Department of Professional Regulation*, 717 F.2d 521, 524 (11th Cir. 1983), and the question becomes one of basic federal supremacy, which does not turn on local factors or local expertise. *South Central Bell*, 744 F.2d at 1123.

Similarly, the rule of *Younger v. Harris*, 401 U.S. 37 (1971), limiting injunctions of pending state proceedings embodies the principle of our federal system that legitimate state functions be respected.[20] This "comity," however, is not strained when a federal court cuts off state proceedings that entrench upon the federal domain. *Baggett*, 717 F.2d at 524. The legitimate state interest contemplated by *Younger*, *see Middlesex County Ethics Committee v. Garden State Bar Association*, 457 U.S. 423, 432 (1982), does not exist when the state action has been preempted

[20]Because of our ultimate conclusion, we may assume without deciding that the *Younger* doctrine, which was developed in the context of state criminal proceedings, applies to the show cause order and proceedings contemplated by the Arkansas Public Service Commission. *See generally Middlesex County Ethics Comm. v. Garden State Bar Ass'n*, 457 U.S. 423, 432 (1982) (discussing scope of *Younger*).

or foreclosed by the Constitution. *Champion International Corp. v. Brown*, 731 F.2d 1406, 1408 (9th Cir. 1984).

Abstention under *Railroad Commission v. Pullman Co.*, 312 U.S. 496 (1941), focuses on whether a decision by a state court might clarify state law so as to make it unnecessary to reach a constitutional issue otherwise presented. Preemption and the commerce clause, however, are matters of federal law, and there is no interpretation of Arkansas law which could make it unnecessary for us to reach the question as to whether the Constitution forecloses even the mere issuance of the show cause order entered here by the APSC. *See Hotel & Restaurant Employees Union Local 54 v. Danziger*, 709 F.2d 815, 832 (3d Cir. 1983), *vacated on the merits sub nom. Brown v. Hotel & Restaurant Employees Union Local 54*, 104 S. Ct. 3179 (1984).

Finally, the doctrine of exhaustion of administrative remedies in the context of state agency proceedings simply addresses many of the same concerns which the various types of abstention are designed to reach. *See* 4 K. Davis, *Administrative Law Treatise* § 25:1, at 350 (1983); *see also West v. Bergland*, 611 F.2d 710, 715–17 (8th Cir. 1979) (developing factors used in determining whether to require exhaustion), *cert. denied*, 449 U.S. 821 (1980).

To the degree that irreparable harm also must be shown, *see West*, 611 F.2d at 719–20, MSE alleges such injury in the form of loss through exhaustion of the very right—the right to be free of the state administrative proceeding—it seeks to protect. The Supreme Court recognized such a right on similar facts in *Public Utilities Commission v. United Fuel Gas Co.*, 317 U.S. 456 (1943), when an interstate gas supplier sought to enjoin the enforcement against it of a state agency order requiring it to prove the reasonableness of the rates it charged a customer utility within that state. Although the agency had done nothing to that point but assert jurisdiction, *id.* at 465, the Court upheld the injunction

on the ground that the supplier suffered injury from the enforcement of the order for proof itself and that the expense of complying with such orders was among the contingencies against which Congress sought to guard in creating exclusive federal jurisdiction. *Id.* at 469; *see also Public Utilities Commission v. United States,* 355 U.S. 534, 540 (1958) ("But where the only question is whether it is constitutional to fasten the administrative procedure onto the litigant, the administrative agency may be defied and judicial relief sought as the only effective way of protecting the asserted constitutional right."); *Panhandle Eastern Pipe Line Co. v. Public Service Commission,* 332 U.S. 507, 512 (1947) (state agency order requiring interstate gas supplier to file certain tariffs, rules, and regulations was not just a threat to apply the state regulatory plan but constituted actual application of the plan in its initial stages); *cf. Monahan v. Nebraska,* 645 F.2d 592, 597 (8th Cir. 1981) (claim that state procedure itself conflicted with federal act could not be effectively addressed by exhausting state procedure).

Here the mere assertion of jurisdiction by the APSC had a negative impact on MSE's ability to obtain investors and complete its project, thus similarly interfering with the exclusive federal scheme for governing interstate power transmission and sales. And, as in *United Fuel,* we observe that MSE raised the preemption question before the APSC in a motion to dismiss the show cause order for lack of jurisdiction and only filed this suit when such motion was denied. 317 U.S. at 470 (distinguishing *Natural Gas Pipeline Co. v. Slattery,* 302 U.S. 300 (1937)). We thus conclude that neither the failure of MSE to pursue further state remedies nor the abstention doctrines of *Burford, Younger,* or *Pullman* make the district court's resolution of this case an abuse of discretion. Nor are we convinced that the district court improperly determined the need for equitable relief or the scope of the injunction.

The judgment of the district court is affirmed.

APPENDIX M

Supplement To Rule 28.1

Statement

FIRMS (OTHER THAN WHOLLY-OWNED SUBSIDIARIES) IN WHICH ALUMINUM COMPANY OF AMERICA HAS OWNERSHIP INTERESTS

Adela Investment Company S.A.
Alcoa Aluminio S.A.
Alcoa Aluminio do Nordeste S.A.—ALCONOR
Alcoa Mineracao S.A.
Mineracao Ceu Estrelado Limitada
Alumar Administracao De Bens S.A. (Realumar)
Alumar Administracao Industrial S.A. (Alumar)
Companhia Geral De Minas
Imobiliaria Vargem Dos Bois S/C Ltda.
Empresa Imobiliaria Maranhense Ltda.
Alcoa-NEC Communications Corp.
Alcoa Nederland B.V.
Alumet Etten B.V.
Intal B.V.
Lips-Levolor B.V.
Alcoa of Australia Limited
A.F.P. Pty. Limited
Alcoa (Bunbury) Pty. Limited
Alcoa of Australia (Asia) Limited
Coala Insurance Company Limited
Dowell Australia Limited
Acme Metal Works, Ltd.
Dowell Brett Pty. Limited
T.G.A. Pty. Limited
The Glass & Aluminium Suppliers Pty. Limited
Portland Smelter Services Pty. Ltd.
Alcoa of Great Britain Limited
Alcoa Manufacturing (G.B.) Limited
MRCP Limited
Aluwhite Electropaint Limited
Alcoa Conductor Accessories, Inc.

Alcoa Fujikura Ltd.
Aludril, Inc.
Aludrum B.V.
Lamitref Aluminium N.V.
Pimalco, Inc.
Drumalu B.V.
Forges de Bologne
Hopewell International Insurance Ltd.
United Insurance Company
Universal Insurance Company of Ireland Limited
Delta International Insurance Company Limited
Delta Holdings, Inc.
Delta America Re Insurance Company
Delta International Insurance Company Limited
Lancer Financial Group
Delaney Management Company, Inc.
Lancer Insurance Company
Transit Casualty Syndicate, Inc.
Aguas Industriales "La Presa" A.C.
Capsulas Metalicas, S.A.
Complejo Industrial Pedernales, S.A.
Corporation For Innovation Development (CID)
Furukawa Aluminum Co., Ltd.
Abe Kogyo Kabushiki Kaisha
Atsugi Aluminum Kogyo Kabushiki Kaisha
Fuji Aluminum Tube Industries, Ltd.
Fujiko Co., Ltd.
Futaba Trading Co., Ltd.
Higashi Nippon Forging Co., Ltd.
Hino Motors, Ltd.
K. K. Kanagawa Alumi Center
Kanehiro Co., Ltd.
Kohmi Metals Co., Ltd.
Light Metal Extrusion Development Company, Ltd.
Meiji Aluminum Co., Ltd.

Nippon Laminate Co., Ltd.
Nippon Light Metal Mfg. Co., Ltd.
Nippon Foil Mfg. Co., Ltd.
Nishi-Nippon Aluminum Co., Ltd.
Nissei Sangyo Co., Ltd.
Panelal Nagoya Co., Ltd.
Sanbi Aluminum Industries, Ltd.
Techno Kogyo Kabushiki Kaisha
Toshin Press Co., Ltd.
Yamada Keikinzoku Co., Ltd.
Yodai Co., Ltd.
Greater Lebanon Hotel Enterprises, Inc.
Grupo Aluminio, S.A. de C.V.
Almexa, S.A. de C.V.
Aluminio, S.A. de C.V.
Inmobiliaria Aluminio, S.A. de C.V.
Halco (Mining) Inc.
Boke Service Company, S.A.
Boke Trading, Inc.
Compagnie Des Bauxites De Guinee (CBG)
Inversiones Araco Compania Anonima
Aco, Sociedad Anonima
Flotillera Oriental, Compania Anonima
Aco Inversora, S.A.
Aco, Sociedad Anonima
Aco, Sociedad Anonima
Aco Inversora, S.A.
Aco, Sociedad Amonima
Auto Cabimas, Sociedad Anonima
Inversora Baralt, C.A.
Inversora Central C.A.
Lago Motors, C.A.
Valfor, Sociedad Anonima
Arrendamientos Aco, S.A.
Auto Cabimas, Sociedad Anonima

Auto Caracas, Sociedad Anonima
Auto Oriente Maturin, S.A.
Auto Oriente, S.A.
Aco Alquiler S.A.
Automotriz Vigia S.A.
Agro Andina, S.A.
Automotriz Panamericana, S.A.
Inversora Central C.A.
Lago Motors, Compania Anonima
Tractosur C.A.
Centromotriz Zulia, C.A.
Cummins de Venezuela, S.A. (CUMMINSA)
Fabrica of Carrocerias Centauro, C.A.
Fabrica Nacional De Tractores Y Motores, S.A. "FANATRACTO"
Hidromex Venezolana C.A.
Inversiones Rialpe, S.A.
Inversora Baralt, C.A.
Inversora Orinoco, C.A.
Lamax S.A.
Aco Inversora, S.A.
Motoriente Ciudad Bolivar C.A.
Motoriente San Felix, S.A.
Motoservicio Ciudad Bolivar, C.A.
Motoriente San Felix, S.A.
Motoriente Ciudad Bolivar, C.A.
Motoservicio San Felix, C.A.
Talleres Unidos De Occidente, C.A.
Centromotriz Zulia, C.A.
Franquicias Unidas Occidente, S.A.
Talleres Unidos De Occidente, C.A.
Automotriz Veritas, S.A.
Flotillera Oriental, Compania Anonima
Talleres Unidos, C.A. (TAUNICA)
Administradora Maracay, C.A.

Amortiguadores, S.A.
Auto Cabimas, Sociedad Anonima
Auto Caracas, Sociedad Anonima
Aco Alquiler S.A.
Aco Alquiler Barquisimeto, S.A.
Aco Alquiler Occidente, S.A.
Aco Alquiler Oriente, S.A.
Flotillas Y Arrendamientos (Floarca), C.A.
Auto Oriente, Sociedad Anonima
Flotillera Oriental, Compania Anonima
Auto Oriente Maturin, S.A.
Flotillera Oriental, Compania Anonima
Autoservicio Maturin, C.A.
Grupo Covenal Mariara, C.A.
Indutrias Fairbanks Morse De Venezuela, S.A.
Inversora Baralt, C.A.
Inversora Central, S.A.
Automotriz Veritas, S.A.
Inversora Covenal, S.A.
Inversiones Auven, C.A.
Inversora Orinoco, C.A.
Aco Alquiler, S.A.
Aco Inversora, S.A.
Auto Oriente Maturin, S.A.
Auto Oriente, Sociedad Anonima
Motoriente Anaco, C.A.
Aco Alquiler Oriente, S.A.
Motoriente Ciudad Bolivar, C.A.
Motoriente El Tigre, C.A.
Aco Alquiler Oriente, C.A.
Motoriente San Felix, C.A.
Occidente Motors, S.A.
Inversora Veritas, S.A.
Lago Motors, Compania Anonima
Inmobiliaria Araure (INMAR, S.A.)

Aco Alquiler, S.A.
Cummins de Venezuela, S.A. (CUMMINSA)
Maquinarias Y Servicios Aco, S.A.
Maquinarias Y Servicios Aco, S.A.
Talleres Unidos, C.A. (TAUNICA)
Aco, Sociedad Anonima
Valfor, Sociedad Anonima
Aco Inversora, S.A.
Auto Cabimas, Sociedad Anonima
Auto Inversora Lamax, S.A.
Automotriz, Panamericana, S.A.
Automotriz Vigia, S.A.
Franquicias Unidas Occidente, S.A.
Industrial Vigia, S.A.
Inversora Central, C.A.
Inversora Baralt, C.A.
Lago Motors, C.A.
Tractosur, C.A.
Auto Cabimas, Sociedad Anonima
Aco Inversora, S.A.
Aco, Sociedad Anonima
Amuay Motors, C.A.
Auto Inversora Lamax, S.A.
Auto Servicio Cabimas, Sociedad Anonima
Franquicias Unidas Occidente, S.A.
Amuay Motor, C.A.
Automotriz Veritas, S.A.
Automotriz Veritas, S.A.
Talleres Unidos De Occidente, C.A.
Deformaciones Plasticas de Metales, C.A.
Forauto, C.A.
Aco Alquiler, S.A.
Agroven, C.A.
Grupo Covenal Mariara, C.A.
Inversiones Almonital, C.A.

Filtravedo, S.A.
Procesos Galvanicos, S.A. "PROGAL"
Sicam de Venezuela, S.A.
Fabrica National De Forros Y Accesorios Para Carros, C.A.
Enmar, C.A.
Inversiones Auven, C.A.
C.A. Venezolana de Produccion Renault
Constructora Venezolana de Vehiculos, C.A.
Filtravedo, S.A.
Inversora Covenal, S.A.
Metalmar, C.A.
Indutrias Mariara S.A. "INDUMAR"
Tupla, C.A.
Inversiones Metalurgicas, C.A.
Administradora Maracay, C.A.
Amortiguadores, C.A.
La Casa Del Amortiguador, S.A.
Auto-Amortiguadores Maturin S.R.L.
La Casa Del Amortiguador Barquisimeto, S.A.
Sinterizados Del Caribe, C.A.
Estampados Del Caribe, C.A.
Trefilerias Mariara, C.A.—TREMARCA
La Casa Del Amortiguador, S.A.
Tupla, C.A.
Tupla, C.A.
Inversiones Araco Compania Anonima
Inversora Baralt, C.A.
Inversora Central, C.A.
Lago Motors, Compania Anonima
Aco, Sociedad Anonima
Amuay Motors, C.A.
Franquicias Unidas Occidente, S.A.
Auto Inversora Lamax, S.A.
Agroven, C.A.
Aco Alquiler Occidente, S.A.

Indutrial Vigia, S.A.
Aco Inversora, S.A.
Aco, Sociedad Anonima
Auto Cabimas, S.A.
Auto Inversora Lamax, S.A.
Automotriz Panamericana, S.A.
Automotriz Vigia, S.A.
Franquicias Unidas Occidente, S.A.
Inversora Baralt, C.A.
Inversora Central, C.A.
Lago Motors, C.A.
Inversora Central, C.A.
Lamax, S.A.
Aco Alquiler Barquisimeto, S.A.
Occidente Motors, S.A.
Aco Alquiler Barquisimeto, S.A.
Inversiones Rialpe, S.A.
Inversiones Rialpe, S.A.
Mineraria Silius, S.p.A.
Fluorsid, S.p.A.
Moralco Limited
Norsk Alcoa A/S
A/S Skibsinvestering
Norsk Alcoa A/S
Mosal Aluminium
Elkem A/S & Co. (Partnership)
Shibazaki Seisakusho Limited
Shibazaki Metal Print Co., Ltd.
Oak Mountain Office Part, Inc.
n.v. hotelmaatschappij "TORARICA"
Swanal Limited

(8)

No. 85-568

In The

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, Attorney General, et al.,

Appellees.

On Appeal from the Supreme Court of North Carolina

APPELLEES' MOTION TO DISMISS APPEAL AND MOTION TO AFFIRM JUDGMENT OF THE NORTH CAROLINA SUPREME COURT

CRISP, DAVIS, SCHWENTKER, PAGE & CURRIN

William T. Crisp*
Robert F. Page
320 South Salisbury Street
Post Office Box 751
Raleigh, North Carolina 27602
(919) 833-2556

Attorneys for: Henry J. Truett; Cherokee, Graham and Jackson Counties; Towns of Andrews, Bryson City, Dillsboro, Robbinsville and Sylva; Swain County Board of County Commissioners; and the Tribal Council of the Eastern Band of Cherokee Indians

*Counsel of Record

LACY H. THORNBURG
ATTORNEY GENERAL
OF NORTH CAROLINA

Richard L. Griffin
Assistant Attorney General
N.C. Department of Justice
Suite 207, Hayes & Hobson Bldg.
20 South Spruce Street
Asheville, North Carolina 28801
(704) 258-6083
Attorney for: the Using and Consuming Public

THE PUBLIC STAFF
NORTH CAROLINA
UTILITIES COMMISSION

Robert Gruber, Exec. Director
James D. Little, Staff Attorney
Post Office Box 29520
Raleigh, North Carolina
27626-0520
(919) 733-6110
Attorney for: the Using and Consuming Public

COCKLE LAW BRIEF PRINTING CO., (800) 835-7427 Ext. 333

37p

QUESTION PRESENTED

In response to the decision of this Court in *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927), Congress enacted the Federal Power Act (16 U.S.C. §§ 791a., *et seq.).* As previously noted by this Court.[1] the intent of Congress in this Act was to create a "bright line" between the Federal Power Commission ("FPC" — now the Federal Energy Regulatory Commission or "FERC") and the various state regulatory commissions, such as the North Carolina Utilities Commission ("NCUC"). The FERC was given exclusive jurisdiction over interstate, wholesale electric power sales and over the transmission of electric energy in interstate commerce (16 U.S.C. § 824(b)). The FERC has no authority to regulate retail, intrastate electric rates and charges. That authority was reserved to the states and to state commissions such as the NCUC. In an earlier opinion involving most of the same parties and facts now before this Court (but a different legal issue), the U.S. Court of Appeals for the Fourth Circuit stated, with respect to the NCUC Order here challenged, that such Order "on its face sets only retail, intrastate rates, an important matter traditionally within the sole discretion of the states, and does not directly conflict with FERC's wholesale and interstate rate setting power."[2] With this in mind, Appellees respectfully submit that this Appeal now presents the following question for decision by the Court:

I. DOES THE ORDER OF THE NORTH CAROLINA UTILITIES COMMISSION, AS AFFIRMED BY THE NORTH CAROLINA COURT OF APPEALS AND THE NORTH CAROLINA SUPREME COURT, PRESENT A SUBSTANTIAL FEDERAL QUESTION?

---

[1] *FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964).

[2] *Aluminum Company of America v. Utilities Commission*, 713 F.2d 1024, 1030 (4th Cir. 1983); *cert. denied*, 104 S. Ct. 1326 (1984).

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

STATEMENT OF THE CASE

A proper resolution of this matter requires the Court to fully understand four things: first, what Alcoa did from 1900-1981; second, what the NCUC did in 1981 and 1982; third, what the FERC did in 1981 and 1982; and, fourth, what the North Carolina Supreme Court did in 1985. The Appellants[3] (and their allies) have omitted most of the relevant facts and have incorrectly characterized the opinions of the NCUC,[4] the FERC and the lower Courts. Appellees will fill in this void. We shall show that Appellants, as they have consistently attempted to do before the NCUC and the lower Courts, both state and federal, are trying to present to this Court a case that does not exist and never did. By omission[5] and mischaracterization, Appellants would have this Court believe

---

[3] Aluminum Company of America (hereafter, "Alcoa"); and its two wholly-owned subsidiaries Nantahala Power and Light Company ("Nantahala" or "NP&L") and Tapoco, Inc. ("Tapoco"). These three Appellants are sometimes referred to, collectively, as "the Companies."

[4] e.g., that the NCUC "investigated" and "disapproved of" FERC filed and approved rates, Jurisdictional Statement ("J.S."), p. 2, n.1; that the NCUC "refused to allow recovery of the wholesale costs allocated to Nantahala by the FERC rate schedules", J.S., p. 4; and that the NCUC reallocated the "economic benefit of this power as if the FERC-regulated New Fontana and 1971 Apportionment Agreements did not exist" by giving a "first call" on all the low-cost hydro power to Nantahala's retail customers, J.S., p. 9.

[5] In their Jurisdictional Statement, Appellants never present to this Court one word about the Alcoa power system that existed in western North Carolina and eastern Tennessee for over 40 years prior to the New Fontana Agreement. Further, they never present one word about the four fundamental findings of fact on which the NCUC's entire opinion is predicated. Their allies also decline to present the facts.

that the NCUC and the North Carolina Supreme Court have, through ignorance or by design, run roughshod over prior opinions interpreting the Federal Power Act and the Supremacy and Commerce Clauses of the United States Constitution. This simply is not so.

The procedural history of this case, including the reversal of the NCUC's erroneous 1977 decision by the North Carolina Supreme Court — *Utilities Commission v. Edmisten,* 299 N.C. 432, 263 S.E.2d 583 (1980) — is concisely presented in the preamble to that Court's lengthy opinion here under review (Appellants' Appendix ("App.") pp. 13a-18a). Upon remand, after joining Alcoa and Tapoco as parties, the NCUC found, based upon substantial evidence: (1) that Tapoco was a North Carolina public utility; (2) that the Nantahala and Tapoco electric systems constituted a *single,* unified, electric public utility system for ratemaking purposes; (3) that, pursuant to N.C.G.S. 62-3(23)2, Alcoa was a North Carolina public utility due to its effect on the rates and services of Nantahala; and (4) that Alcoa so dominated Nantahala that Nantahala " . . . has been left but an empty shell, unable to act in its own self-interest, let alone in the interest of its public utility customers in North Carolina."[6] (App. pp. 178a-179a.) Based upon these essential findings of fact, the NCUC determined the rate base and expenses of the single Nantahala-Tapoco system, allocated the appropriate costs to Nantahala's North Carolina retail jurisdiction, and set retail rates such that there was a rate

[6] These, of course, are the four fundamental findings of fact referred to in footnote 5, *supra.* As we have noted, Appellants do not see fit to mention any of them.

reduction from the level previously approved. Consistent with the rate reduction, Nantahala was ordered to refund the excess rates it had been collecting. Alcoa, due to its domination, was ordered to refund such portion of the total refund amount as Nantahala was financially unable to make.

Upon appeal by the Companies, the North Carolina Court of Appeals and the North Carolina Supreme Court affirmed all relevant Commission orders. *Utilities Commission v. Edmisten,* 65 N.C. App. 198, 309 S.E.2d 473 (1983); *Utilities Commission v. Edmisten,* 313 N.C. 614, 332 S.E. 2d 397 (1985). Meanwhile, Alcoa and Tapoco, but not Nantahala, had filed a complaint in the United States District Court for the Eastern District of Tennessee, seeking to enjoin the NCUC. The complaint was transferred to the United States District Court for the Eastern District of North Carolina, which granted a motion to dismiss on abstention grounds. This ruling was unanimously affirmed by the Fourth Circuit, *Aluminum Company of America v. Utilities Commission,* 713 F.2d 1024 (4th Cir. 1983), *cert. denied,* 104 S. Ct. 1326 (1984). The Fourth Circuit recognized that the NCUC's order, on its face, did not directly conflict with FERC's wholesale and interstate rate setting power.

STATEMENT OF FACTS

The opinion of the North Carolina Supreme Court and the NCUC's initial Order each contain a lengthy description of the factual history of this matter (App. pp. 13a-32a and 166a-235a). These facts are unique in the electric power industry. An implicit assumption of Appellants' Jurisdictional Statement is that the "Alcoa power system" is indistinguishable from a traditional electric power company or holding company system such as the Southern System or the Middle South System. This is not true. The only apparent reason for Appellants' reluctance to discuss the actual facts of this case is that they completely undercut Appellants' legal arguments. The principal facts determined by the NCUC and affirmed by the North Carolina Supreme Court are the following:

1. In the early 1900's, Alcoa came to North Carolina seeking low-cost power to serve its aluminum reduction plant in Alcoa, Tennessee (App., p. 18a).

2. Rather than acquiring land in its own name, Alcoa acquired two existing public utility companies, Knoxville Power Company ("Knoxville", later, Tapoco) in Tennessee and Tallassee Power Company ("Tallassee", later Carolina Aluminum, Inc., still later Yadkin, Inc.) in North Carolina (App. pp. 18a, 22-24a).

3. During the 1920's, through the use of these public utility subsidiaries, Alcoa acquired substantial control of the major hydroelectric sites located along the Little Tennessee River in North Carolina and Tennessee (App. p. 18a).

4. Despite the fact that it already owned Knoxville and Tallassee, Alcoa created Nantahala, in 1929, as yet

another wholly-owned public utility subsidiary. Between 1929-1939, Tallassee sold its undeveloped hydroelectric sites to Nantahala (App. p. 19a), while it kept the low-cost Cheoah and Santeetlah sites (which had already been developed and which Alcoa subsequently caused to be conveyed to Tapoco).

5. Between 1929 and 1941, Nantahala undertook token public service (App. p. 19a). Most of Nantahala's power was sold to Alcoa. In 1941, Nantahala obtained a certificate from the War Department to construct the Nantahala and Glenville hydroelectric projects. The stated justification for such certificate was Alcoa's huge electric needs. The Nantahala and Glenville projects were repeatedly referred to as being a part of the "Alcoa power system" (App. p. 19a).

6. Also in 1941, both Alcoa (through Nantahala) and the Tennessee Valley Authority (TVA) were interested in developing a large hydroelectric project at Fontana, North Carolina. After a determination by FPC that the project would require a license under Part I of the Federal Power Act ("the Act"), Nantahala abandoned the project.[7]

7. Subsequently, Alcoa and TVA entered into the original Fontana Agreement ("OFA"). Under this Agreement, Alcoa caused Nantahala (which was not even a party to the OFA) to transfer the Fontana site to Alcoa, at less than fair market value, in exchange for downstream

[7] This was by no means the only instance in which Alcoa attempted to avoid submitting its facilities or those of its subsidiaries to regulation by the FPC. See, e.g., *Nantahala Power and Light Co.*, 2 F.P.C. 388 (1941); also App. pp. 19-20a (n5), 22-23a, 29a, 31a.

storage benefits to Tapoco. Nantahala, Tallassee (by then, Carolina Aluminum) and Knoxville were compelled to turn over all the output of their hydroelectric plants to TVA in exchange for TVA return power entitlements, most of which flowed to Alcoa. At that time, Nantahala's public load could easily be satisfied out of the TVA return power allocated to Nantahala. The balance of Nantahala's return power was sold to Alcoa at "dump" (i.e., below cost) prices (App. pp. 20-21a). In 1954, Alcoa and Nantahala signed a contract which required Nantahala to sell its excess power to Alcoa at very low rates. The 1954 contract also called for Alcoa to make power available to Nantahala when Nantahala could not meet its public service obligations.

8. The OFA was never submitted to the FPC as a rate schedule or ruled upon by FPC, for its lawfulness, during its entire 20-year term (App. p. 22a).

9. In 1954, FPC ruled that the Cheoah and Santeetlah (N.C.) and Calderwood (Tenn.) facilities would have to be licensed under Part I of the Act. Alcoa subsequently caused Knoxville Power to change its name to Tapoco, Inc. and caused Tapoco to domesticate in North Carolina. Tapoco thereby succeeded Knoxville as owner of the Calderwood dam. In October, 1954, Tapoco and Carolina Aluminum (formerly Tallassee, subsequently Yadkin, Inc. — the owner of the Santeetlah and Cheoah dams) jointly applied to FPC for a Part I license for the "Tallassee Project". By June, 1955, Tapoco had become the licensee of the "Tallassee Project" (App. p. 24a).

10. As part of its FPC license filing, Tapoco was required to comply with all applicable state laws. In February, 1955, Tapoco applied to the NCUC for a state public

utility certificate. The certificate which was issued by the NCUC has never been abandoned, revoked, or amended and it directs Tapoco to make certain power available for Nantahala and its customers (App. p. 25a).

11. Tapoco later sold its distribution facilities and freed itself from any further responsibility to the public in Tennessee. Tennessee has not, thereafter, exercised any regulatory control over Tapoco.[8] Since 1955, almost all of Tapoco's TVA return power entitlements have been devoted to Alcoa's private aluminum production facilities. Some five years later, Alcoa tried to shed its remaining public responsibility by selling Nantahala's distribution system (but not its hydro dams and projects) to Duke Power Company. This attempt was rejected by the North Carolina Supreme Court, since it was not shown to be in the public interest. *Utilities Commission v. Membership Corporation*, 260 N.C. 59, 131 S.E. 2d 865 (1963); (App. pp. 25-26a, 28-29a).

12. Nantahala added generation during the 1950-1955 period to allow it to provide more power to Alcoa. Despite its increasing public load, Nantahala has added no generating capacity to its system since 1957 (App. p. 26a).

13. During the period 1940-1950, Nantahala sold over 80% of its power to Alcoa at very low rates. By 1953, this relationship between Alcoa and Nantahala was held to

[8] Thus, the suggestion made by Tennessee, on p. 9 of its *Amicus Curiae* brief, which hypothesizes a decision by the Tennessee PSC to set Tapoco's retail rates on a roll-in basis is, at best, merely whimsical; at worst, it is deliberately misleading.

have resulted in discrimination against Nantahala's retail customers.[9]

14. From the beginning of the OFA (1941) through the end of the test period in this case (1975), Alcoa always had to purchase some, at times the greater part, of its power requirements from TVA. In 1975, for example, while Alcoa purchased 1,365,499,000 kwh from Tapoco, it purchased an additional 1,784,833,000 kwh from TVA (App. p. 25a).[10]

15. From 1960-1962, Alcoa and TVA negotiated the New Fontana Agreement ("NFA") to succeed, in part, the OFA. The Agreements were similar, with all the Nantahala and Tapoco generation being turned over to TVA, in exchange for TVA return power entitlements designed

[9] In its opinion in *Utilities Commission v. Mead Corporation*, 238 N.C. 451, 78 S.E. 2d 290 (1953), the North Carolina Supreme Court discussed this discrimination. Nantahala sought to increase its rates for all customers, *except* Alcoa, even though Alcoa got more than 80% of Nantahala's power, at rates which were less than the cost of producing the power. Other large industrial customers were paying rates approximately double Alcoa's rate. Nantahala's attempt to distinguish between "primary" and "secondary" power was held to be a distinction without a difference. The North Carolina Supreme Court rejected Nantahala's attempt to give an unlawful preference to Alcoa.

[10] Alcoa complained below that the "cost" of its separate power purchases from TVA should have been put into the single system "pot" and allocated to Nantahala and Tapoco. The NCUC's well-reasoned response to this assertion was twofold: (1) since the supplemental purchase contract was a separate matter between Alcoa and TVA (Tapoco was not a party), this power was not available for use in the Nantahala-Tapoco single system and should not be included in the single system "pot"; and, (2) since the power sold under the contract was "customer specific" (i.e., tailored to meet Alcoa's high load factor needs and not the fluctuating needs of the public load), all costs attributable to such power would have to be allocated directly to Alcoa, even if such costs properly belonged in the single system "pot" (App. pp. 211a-215a; 66a-67a).

to serve a high load factor customer (such as an aluminum smelter) and not a public load (App. pp. 28-29a).

16. Just as with the OFA, the NFA[11] left it to the Companies to determine how to divide the power and energy. This was initially done in a 1963 Agreement which guaranteed Nantahala the greater of its annual "primary energy capability" (360,000,000 kwh) or its actual annual generation (which averaged 424,000,000 kwh). There was no demand limitation on Nantahala's use of its return power entitlements. Unlike the previous 1954 Alcoa-Nantahala agreement, no obligation was imposed upon Alcoa to make up any shortfall when Nantahala's power was insufficient to meet its public load (App. pp. 29-30a).

17. From 1963-1971, Nantahala was still selling power to Alcoa. Thereafter, Nantahala had no excess power to sell. Alcoa caused Tapoco and Nantahala to enter into a new 1971 Apportionment Agreement.[12] Under this 1971 Agreement, Nantahala's share of the NFA entitlements was reduced to only its primary generation (360,000,000 kwh). In addition, a demand limitation of 54,300 KW was placed on Nantahala's use of its return power entitlements. All of the remaining NFA entitlements were allocated to Tapoco, for Alcoa's benefit. In addition, Alcoa ceased making the $89,000 annual payment to Nantahala which it had made under the 1963 Agreement. As a result of its growing public load and the 1971 Agreement's

[11] The NFA was not filed at FPC until 1966, when FPC specifically requested both Tapoco and Nantahala to file it. Both filings were made "under protest" (subject to their right to contest the FPC's authority to regulate any aspect of the NFA) since the other principal party, TVA, was not subject to FPC regulation (App. p. 29a).

[12] For a lengthy discussion of all the detriments to Nantahala arising out of both the NFA and the 1971 Apportionment Agreement, please refer to App. pp. 179a-205a.

reallocation of return power from the NFA, Nantahala was required to enter into an expensive supplemental power purchase contract with TVA.[13] (App. pp. 30-36a).

18. Since 1971, Nantahala has been required to purchase ever-increasing amounts of high cost power from TVA to serve its public load, even though Nantahala's own generation frequently exceeded its public load requirements[14] (App. p. 32a).

19. Based on the foregoing historical facts, the NCUC made the four fundamental findings of fact upon which its decision to use the roll-in ratemaking methodology was predicated. See page 2, *supra*. These facts, which are binding on appeal and do not involve any federal questions, concern the single Nantahala-Tapoco system, the public utility status of Alcoa and Tapoco, and Alcoa's domination of Nantahala.[15] Appellees impose upon the

[13] The 1971 Agreement was not filed at FERC until 1980, once again under protest (App. p. 31a). Thus, if for no other reason, the NCUC is not preempted because the 1971 Agreement was not a "filed rate" during the test year in this case, 1975.

[14] For example, during the 1975 test year in this case, Nantahala's actual generation was about 560,000,000 kwh and its public load was only slightly above 450,000,000 kwh. Despite this, Nantahala was required to purchase an additional 81,265,370 kwh from TVA, at a cost of $1,500,000 (Appellants' App. p. 31a).

[15] Contrary to the assertion of Alcoa and its allies, this case does *not* involve a jurisdictional dispute between North Carolina and Tennessee. (Tennessee ceased regulating Tapoco (or Knoxville), at the latest, in 1955 when Tapoco sold its public load distribution systems.) The dispute *is* between the reasonable needs of Nantahala's public load versus Alcoa's ongoing attempts to accord preferences to itself through manipulation of its subsidiaries. It is the fact of Alcoa's status as Nantahala's sole stockholder, as a North Carolina public utility and its domination of Nantahala, for Alcoa's benefit, not the alleged fact of Alcoa's status as a "Tennessee customer", that resulted in Alcoa being held jointly liable for the refund amounts (App. pp. 230a-233a).

Court's time for this lengthy recitation of facts for one crucial reason. The facts demonstrate that the historical development of the "Alcoa power system" is unique in the electric power industry. The "Alcoa power system" cannot be compared to other, traditional electric utilities, whether they be individual utilities like Duke Power Company or holding company systems like Middle South Utilities.[16] For these reasons, the final result reached in this case cannot be extended to the electric power industry generally.

MOTION TO DISMISS OR AFFIRM

Pursuant to Rule 16 of the Rules of the Supreme Court of the United States, Appellees move to dismiss the Ap-

[16] For example, in none of the other, more traditional power systems is the parent corporation engaged in a principal business separate from the production, transmission and distribution of electric power. In none of them is the parent the largest customer of the power system. In none of them has the veil of corporate separateness between parent and subsidiary been pierced. In none of them is there a consistent history of the parent's attempt to avoid reasonable state and federal regulation and to "cut away" power resources originally dedicated to serve the public to the sole and exclusive benefit of the parent's manufacturing operations. In its *Amicus Curiae* brief, Edison Electric Institute (EEI) largely ignored the factual basis of the NCUC's decision. For example, on p. 5 of its brief, EEI states that "Nantahala and Tapoco are separate corporations," completely ignoring the NCUC's finding that they constitute a single system for ratemaking purposes. However, EEI does appear to concede, in the hypothetical assumptions on p. 12 of its brief, that the true facts of this case are not those about which EEI or its members might properly be concerned. Dismissal of the present appeal or affirming the judgment of the North Carolina Supreme Court will not affect EEI or its traditional utility members.

peals of Alcoa, Tapoco and Nantahala for the reason that they present no substantial federal questions. In addition, Appellees move to affirm the Judgment and Opinion of the North Carolina Supreme Court on the ground that such opinion, based upon the facts determined below, was correctly decided. Finally, Appellees contend that the Appeal should not be favorably treated, alternatively, as a Petition for Writ of Certiorari and that a Writ of Certiorari should not issue.

———o———

ARGUMENT

I. The order of the North Carolina Utilities Commission, as affirmed by the North Carolina Court of Appeals and the North Carolina Supreme Court, does not present a substantial federal question.

The Companies have now argued their federal questions before the NCUC and both of the North Carolina Appellate Courts. In the longest opinion in its two hundred year history, the North Carolina Supreme Court treated the federal questions exhaustively. Despite the depth of examination and treatment of the various federal questions, the North Carolina Supreme Court had no difficulty in disposing of these questions adversely to Appellants, because it is obvious that their arguments and the cases upon which they rely are just not applicable to the unique factual circumstances of this case. This is *not* a case where the NCUC disallowed FERC-approved wholesale power costs on the grounds that such costs were unreasonable. Instead, the Commission considered and allowed all relevant costs in the single-system "pot" and allocated

the proper portion of such rolled-in costs, using traditionally accepted allocation methods, to the Nantahala retail load.

Appellants' arguments are, in brief summary, predicated upon assumed facts that: (1) Nantahala is a "stand alone" utility; (2) Tapoco is not a North Carolina public utility; (3) Alcoa is not a North Carolina public utility for any purpose; and, (4) Alcoa has not dominated its subsidiaries so as to compel a piercing of the corporate veil. Such arguments are premised on a set of facts as Appellants want them to be, rather than what they really are, with the inevitable consequence that their arguments collapse when meeting the actual facts, as found by the NCUC and affirmed on appeal. We address each of Appellants' major legal arguments hereafter.

A. The Roll-In Is Not Barred By Part II Of The Federal Power Act.

The Companies argue that the NCUC's roll-in is contrary to the federal preemption doctrine under Article VI, Clause 2 of the United States Constitution, as applied to Part II of the Federal Power Act (16 U.S.C. § 824, *et seq.).* Several cases are cited as illustrative of the impermissible parameters of the roll-in. However, these cases are distinguishable in that the various state commissions disallowed actual costs arising from filed rates, while in the roll-in methodology at hand, all costs properly arising from the FERC-filed rates were considered in the single Nantahala-Tapoco system. In addition, all of these cases involved traditional electric public utilities and holding companies, not the unique facts of the "Alcoa power system."

1. The FERC's Opinions Do Not Preclude Roll-In As Applied By The NCUC.

The NCUC's roll-in decision sets Nantahala's retail rates in a way that redresses the corporate abuse which the NCUC found among three affiliated North Carolina public utilities — Alcoa, Tapoco and Nantahala. The NCUC looked through this needlessly complex corporate structure to find a single, integrated Nantahala/Tapoco system and Alcoa domination of Nantahala. In light of these findings, the NCUC rolled-in the costs of the two companies and allocated them, using a traditional rate-making allocation methodology.[17] As noted by the North Carolina Supreme Court, this methodology is commonly employed in setting the retail rates for utilities operating in more than one state. *Utilities Commission v. Edmisten*, 313 N.C. 614, 332 S.E.2d 397 (1985), (App. p. 55a). The NCUC rejected the methodology proposed by Nantahala and Alcoa — allocation of *single system costs* along the lines of the *separate system* NFA and 1971 Apportionment Agreement — because in entering into these Agreements, Nantahala had been compelled to give up benefits and to incur unnecessary costs solely to benefit Alcoa. Such costs did not benefit the retail customers.

When faced with contemporaneous requests to use the roll-in methodology for setting rates to Nantahala's three wholesale customers (7% of NP&L's public load), FERC declined to exercise its § 205 ratemaking (legislative) discretion to do so. *Nantahala Power and Light Company*,

[17] Costs were allocated to the Nantahala retail load based upon the retail load's actual energy and demand requirements as a proportion of the total Nantahala and Tapoco single system requirements.

Opinion No. 139, 19 F.E.R.C. ¶ 61,152; *reh'g denied*, Opinion No. 139-A, 20 F.E.R.C. ¶ 61,430; Opinion No. 139-B, 21 F.E.R.C. ¶ 61,222 (1982); *aff'd*, *Nantahala Power and Light Company v. FERC*, 727 F.2d 1342 (4th Cir. 1984). FERC did determine that the 1971 Apportionment Agreement was unfair to Nantahala, but it declined to reform the Agreement and set Nantahala's *wholesale rates* as if Nantahala had received 44 million kwh more of the TVA return energy (from the NFA) than it was entitled to receive pursuant to the 1971 Agreement.[18] Without such reformation, NP&L's retail customers could not (and did not) benefit from FERC's determination that the 1971 Apportionment Agreement was unfair. Based upon this discretionary exercise of FERC's *legislative* (ratemaking) authority, Appellants now contend that the NCUC's decision unlawfully invades a domain exclusively occupied and preempted by the FERC.

As to Appellants' first preemption argument—that FERC's decision not to employ roll-in to set wholesale rates precluded the NCUC from using roll-in—the FERC explicitly recognized that the NCUC, operating under discrete State criteria, could validly require roll-in for setting *retail* rates. FERC stated, after having a full opportunity to review the NCUC's September 2, 1981 decision (which had been lodged before it):

> We recognize that the North Carolina Utilities Commission ("NCUC"), based on a similar record, reached a different conclusion concerning roll-in costing. However, *the question of whether to treat various entities as an integrated system for ratemaking purposes is not a purely factual question but also rests on criteria which each ratemaking authority may deem relevant* (Emphasis supplied).

[18] App. pp. 293a, 295a, 298a, 309a, 311a.

App. p. 305a. FERC thus recognized that use of roll-in by the NCUC, in its exercise of retail ratemaking authority, does not conflict with FERC's decision.[19]

FERC correctly noted the independence of Federal and State ratemaking determinations. It has been repeatedly recognized that Federal and State regulatory commissions can adopt different ratemaking policies. *See, e.g., Mid-Tex Electric Cooperative, Inc. v. FERC*, No. 83-2058, slip op. at pp. 50-61 (D.C. Cir. Sept. 24, 1985); *Public Systems v. FERC*, 709 F.2d 73, 84 (D.C. Cir. 1983). Roll-in is no special exception to this rule, as FERC itself recognized (App. p. 305a). Contrary to the impression Appellants seek to convey, in several important respects the NCUC's methodology was *more favorable* to Nantahala than FERC's. FERC disallowed the non-fuel component of Nantahala's purchased power adjustment clause (the entire clause was acceptable to the NCUC) and FERC rejected Nantahala's treatment of wartime depreciation (which had been approved by the NCUC). In addition, the NCUC used a fair value rate base and a different rate of return than FERC.

---

[19] In view of FERC's specific holding just quoted, the positions taken by the Solicitor General and counsel for FERC in their *Amicus Curiae* brief are inexplicable. They obviously are in conflict with the position previously taken by FERC. Counsel for the FERC now, apparently, contends that FERC was wearing its administrative (or § 206) "hat" in Opinion 139 and that FERC specifically approved the cost and power allocations arising from the NFA and the 1971 Agreement. The Fourth Circuit, in affirming FERC's opinions, clearly understood that FERC was not acting administratively, but was wearing its broader, more discretionary, legislative (ratemaking) "hat". The Fourth Circuit stated: "While . . . this evidence does suggest a basis for the Commission to order rolled-in costing, it does not compel the conclusion that the Commission must, as a matter of law, consolidate costs for ratemaking purposes. A decision to order roll-in is essentially a matter of Commission discretion . . ." *Nantahala Power and Light Co. v. FERC*, 727 F.2d 1342, 1348 (4th Cir. 1984).

The two Commissions viewed the issues confronting them in distinctly different ways when making their disparate ratemaking determinations as to roll-in. The NCUC was not dealing with the stated FERC issue of whether "Alcoa has used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act" (App. p. 290a). Instead, the NCUC was concerned with whether fair and reasonable retail rates could be established if Nantahala were viewed as a "stand alone" company (App. p. 137a). FERC cannot lawfully preclude North Carolina from making that decision, in setting retail rates, as FERC openly acknowledged (App. p. 305a).

Appellants' second preemption argument is that, even if retail roll-in is technically permissible, the NCUC is still not free to interfere with the Alcoa-directed "allocation" of power entitlements between the two distinct loads served by the single system: Nantahala's public load and Tapoco's industrial load. This argument asserts that, because Alcoa deliberately created or acquired two seperate utility companies (where one would have sufficed) and directed them to enter into allocation transactions, some of which were belatedly filed at FERC,[20] the NCUC was precluded from using roll-in to protect North Carolina retail customers

---

[20] The 1941 OFA was never filed for FERC approval during its 20 year life *(Tapoco, Inc., et al.*, 30 F.E.R.C. ¶ 65,050 at ¶ 65,274). Neither was the 1954 Apportionment Agreement *(Id.* 30 F.E.R.C. at ¶ 65,275). Neither was the 1963 Apportionment Agreement *(Id.* 30 F.E.R.C. at ¶ 65,277). The NFA, which became effective in January 1963, was not filed until 1966 and it was filed "under protest"—i.e., subject to NP&L's and Tapoco's right to contest F.E.R.C.'s jurisdiction over the NFA (App. p. 29a). Finally, the 1971 Apportionment Agreement was not filed as a tariff until 1980 (App. p. 31a). *Nantahala Power and Light Co.*, 2 FPC 388 (1941) also discusses Alcoa's strenuous attempts to avoid federal regulation of its subsidiaries' hydroelectric projects.

from the corporate abuse it found among the three North Carolina public utilities.

Alcoa's second argument can best be examined by observing FERC's treatment of the NFA and the 1971 Agreement for ratemaking purposes. The ultimate issue in Opinion 139 was the justness and reasonableness of Nantahala's request for a 28% wholesale rate increase. FERC did not review the two Agreements for their independent "justness and reasonableness" under § 206 of the Federal Power Act (i.e., FERC was not wearing its regulatory or administrative "hat"). Rather, FERC viewed the fairness of the Agreements only under § 205 of the Act, for the limited purpose of determining the reasonableness of Nantahala's proposed wholesale rates. In this limited context, FERC did not accept the contention that Alcoa, through the OFA or the NFA, intentionally deprived Nantahala of adequate hydroelectric generating facilities (App. p. 295a). However, FERC found that "the apportionment agreements are another matter" (App. p. 295a). The FERC specifically found that "the 1971 Agreement is unfair" (App. p. 293a) and that, in entering such Agreement, Nantahala gave up substantial benefits contained in its 1963 Agreement with Alcoa, without consideration (App. pp. 295-296a). FERC then determined that, regardless of the provisions of the 1971 Apportionment Agreement, Nantahala should be required to use a fairer level of entitlements in developing its costs for wholesale ratemaking purposes. With regard to the refund of excessive wholesale rates collected by NP&L, FERC held that Nantahala should refund any amounts collected in excess of those payable by the customers if Nantahala had been fairly treated in the 1971 Agreement (App. p. 298a).

FERC expressly declined to exercise its authority to reform the 1971 Apportionment Agreement to reflect the increased Nantahala entitlements it had found appropriate for purposes of setting Nantahala's wholesale rates and stated: "Our decision here does not reform the 1971 Agreement . . . The effect of this opinion is to provide entitlements to Nantahala which will result in just and reasonable rates to its wholesale customers" (App. p. 298a). In its Opinion on Rehearing, FERC again acknowledged that it " . . . did not choose to reform the 1971 Apportionment Agreement" (App. p. 309a). In short, in determining the just and reasonable rates to be charged Nantahala's wholesale ratepayers, FERC did not reform the filed rates. Instead, it established Nantahala's wholesale rates *as if* the 1971 Agreement had been reformed, by awarding NP&L an additional 44,000,000 kwh annually, in order to fix rates which FERC deemed fair to Nantahala's wholesole customers. FERC's approach is analogous to the NCUC's, which in no way revised or reformed the actual contractual relationships—the flow of power and dollars among TVA and the North Carolina utilities. Through its employment of roll-in and a conventional cost allocation methodology, the NCUC merely assured that Nantahala's ratepayers did not pay excessive rates. Obviously, if FERC had intended to approve the NFA and the 1971 Agreement for purposes of power and cost allocation (as opposed to ratemaking), it would have been required to reform the 1971 Agreement. Only such a direct reformation would benefit *all* of Nantahala's customers.

The great intentions of Congress in the Federal Power Act—to protect the consumer, to fill the *Attleboro*[21] gap,

[21] *Public Utilities Comm. v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).

and to respect the role of the States in retail rate regulation—cannot be converted into a requirement that, under the unique factual circumstances present here, would result in clear oppression of the retail ratepayers. Federal preemption was never intended to require retail ratepayers to pay rates which would be unreasonable under the findings and reasoning of both the FERC and the NCUC (Appellants do not even specify the preemption standard to which the NCUC is to be held—the "filed rates" *per se*, or the filed rates as adjudicated (but not reformed) by FERC.) FERC's limited determination not to roll-in Nantahala and Tapoco for wholesale ratemaking purposes does not preempt the NCUC from ordering a retail roll-in based upon North Carolina law and other criteria which the NCUC deemed relevant (App. p. 305a).

2. The NCUC's Determination Does Not Conflict With The "Narragansett Doctrine."

As their third preemption argument under the Supremacy Clause—that the NCUC improperly reallocated both power and costs in violation of the filed-rate doctrine—Appellants attempt to twist the facts of this case into the mold of the *"Narragansett-Northern States"* line of preemption cases,[22] upon the assumption that Opinion 139 actually allocated power and costs. As we have just shown, however, FERC *did not* allocate power and costs with respect to the NFA and the 1971 Apportionment Agreement. Actually, the orders of the NCUC are entirely consistent with the filed-rate doctrine, under which

[22] *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978); *Northern States Power Co. v. Hagen*, 314 N.W.2d 32 (N.D. 1981); *Northern States Power Co. v. Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn. 1983), *cert. denied*, 104 S.Ct. 3546 (1984).

a State retail order is invalid if it interferes with an actual or potential FERC determination as to the justness and reasonableness of a wholesale rate or an interstate electric power transaction. Some State courts, as noted by Appellants, have held that a State Commission may not disallow a FERC-approved wholesale power cost on the basis of a determination that the FERC-approved rate was unreasonable.[23] Other courts have struck down retail rate orders that interfered with FERC orders allocating the costs of certain nuclear generating facilities among affiliated utilities.[24] In each of those cases, however, the

[23] *Narragansett Electric Co. v. Burke, supra*, (State commission engaged in searching inquiry into wholesale supplier's costs and concluded that the wholesale rates charged to and paid by local utility for purchased power were excessive); *United Gas Corp. v. Mississippi Public Service Comm'n*, 240 Miss. 405,127 So. 2d 404 (1961) (State commission refused to allow wholesale purchased gas expenses in retail rates because FTC had not yet determined whether they were just and reasonable; *held* that State commission must allow the expenses to be collected in retail rates, subject to refund, pending FPC determination); *City of Chicago v. Illinois Commerce Comm'n*, 13 Ill. 2d 607, 150 N.E. 2d 776, 780-81 (1958); *Citizens Gas Users Ass'n v. Public Utilities Comm'n of Ohio*, 165 Ohio 536, 138 N.E. 2d 383 (1956) (State commission cannot disallow as unreasonable from retail operating expenses the cost of gas purchased at wholesale under FPC-jurisdictional tariffs); *Office of Public Counsellor v. Indiana & Michigan Electric Co.*, 416 N.E. 2d 161 (Ind. App. 1981) (State commission reversed when it consolidated a retail electric utility and a wholly-owned nuclear subsidiary, and set a single rate of return for the rolled-in assets, when the result was to eliminate the higher rate of return fixed by the FERC for the wholesale electric rates charged by the subsidiary to the parent).

[24] *Northern States Power Co. v. Minnesota Public Utilities Comm., supra; Northern States Power Co. v. Hagen, supra* (affiliated utilities allocated canceled nuclear plant costs between themselves by means of a wholesale bulk power sales contract, filed with and litigated before the FERC; *held* that State Commissions could not set the retail rates of these uilities so as to alter or interfere with the FERC's determination of the just and

(Continued on next page)

State orders were clearly intended to frustrate a prior or anticipated FERC order allocating such costs.

The NCUC order here being challenged is not controlled by either of the foregoing line of cases because (a) the NCUC did *not* base its roll-in order on a determination that a wholesale filed rate approved by, modified by or being litigated at the FERC was unreasonable, and (b) the NCUC did *not* interfere with a FERC § 206 allocation of costs among States or among utilities. Rather, the NCUC set Nantahala's retail rates on the basis of its determination of which of the Nantahala-Tapoco single system's total costs—including *all* costs incurred pursuant to the NFA and the 1971 Apportionment Agreement—could fairly be considered to have been incurred for the benefit of Nantahala's retail customers. Several courts which have addressed fact and policy situations analogous to the facts presented here have ruled that the *Narragansett-Northern States* doctrine does *not* require States to charge retail customers for costs which were not reasonably incurred to serve them.

In *Public Service Co. of Colorado v. Public Utilities Comm. of Colorado*, 644 P.2d 933 (Colo. 1982), the Colorado Supreme Court reviewed an order of the Colorado PUC regarding the retail treatment of FERC-approved

(Continued from previous page)

reasonable allocation of those costs). *Eastern Edison Co. v. Department of Public Utilities*, 388 Mass. 292, 446 N.E. 2d 684 (1983) (wholesale rates paid by retail utility included wholesale supplier's costs of abandoned nuclear plant); *See also Middle South Energy, Inc. v. Arkansas Public Service Comm'n*, Nos. 84-2409, *et al.* (8th Cir., August 23, 1985) (enjoining State attempt to prevent a utility from including costs of the Grand Gulf nuclear facility in its retail rates, despite FERC orders allocating those costs between the utility and affiliated utilities in other States, belonging to the same holding company system, pursuant to a series of FERC-jurisdictional interstate bulk power contracts; Court relied on a burden on interstate commerce analysis, but indicated possible preemption problems as well).

costs of participation in the Gas Research Institute ("GRI"), an industry-wide natural gas R & D program. The Colorado Commission agreed that it had to treat these costs as reasonably incurred operating expenses. However, it stated that, under the *Narragansett* rule[25] it was free to determine whether those costs should be automatically passed through in retail rates. The Colorado Commission questioned the propriety of forcing retail customers to bear this expense, because the customers would exercise no control over the expenditure of GRI funds, and customers would benefit from GRI's activities only in the future, if at all, with most of the potential benefits going to the gas utilities themselves, to energy development corporations, and to other private interests.

The Colorado Commission's decision was upheld by the Colorado Supreme Court, which agreed that these expenses need not be passed through automatically to consumers. The Court concluded that the Colorado PUC had the authority to scrutinize such costs in a general retail rate case "to balance the interests of utility investors and the ultimate consumers in arriving at a just and reasonable rate . . ." *Public Service Co. of Colorado v. Colorado PUC*, *supra*, 644 P.2d at 941.[26]

[25] In *Narragansett, supra*, 381 A.2d at 1363, the Rhode Island Supreme Court required the Commission to treat a utility's wholesale power purchase from an affiliate pursuant to a FERC rate schedule as an actual, reasonable operating expense, but also held that the Commission need not allow the expense to be flowed through automatically to retail customers by means of a purchased power adjustment clause.

[26] See also *Eastern Edison Co. v. Department of Public Utilities*, 388 Mass. 292, *supra*, where the Massachusetts Supreme Judicial Court discussed with apparent approval the above holdings of the Rhode Island Supreme Court in *Narragansett* and of the Colorado Supreme Court in *Public Service Co. of Colorado*, distinguishing them on the grounds that the Massachusetts statute specifically required automatic flow-through of all reasonably incurred fuel and purchased power expenses.

Washington Gas Light Co. v. Public Service Comm. of the District of Columbia, 452 A.2d 375 (D. C. 1982), *cert. denied,* 462 U.S. 1107 (1983) is similar. The Court reversed the D.C. Commission, however, because it found that the Commission's decision was based on the preempted conclusion that the wholesale increase was unreasonable, not on the permissible conclusion that the expenses, even though reasonable, should not be passed along in retail rates.

A recent decision by the New Hampshire Supreme Court is consistent with this line of authority—that while a State Commission may not review FERC-approved rates for their reasonableness, it is free to determine, under state law, whether the wholesale costs should be flowed through in retail rates. *Appeal of Sinclair Machine Products, Inc., et al.,* — N.H. —, Case No. 84-380 (issued July 26, 1985). In the *Sinclair* case, Connecticut Valley Electric Company ("CVEC") filed a general retail rate increase. A major portion of CVEC's increase was based upon the wholesale rates which CVEC paid to its power supplier, Central Vermont Public Service Corporation ("Cen. Vt."). CVEC was a wholly-owned subsidiary of Cen. Vt. Pursuant to a unilateral settlement agreement proposed by Cen. Vt., FERC approved the wholesale rates charged by Cen. Vt. to CVEC. Such rates included a pass-through of Cen. Vt.'s cost of two abandoned nuclear plants. Inclusion of these costs in CVEC's retail rates was challenged on the basis of New Hampshire's anti-CWIP statute.

The New Hampshire PUC ruled that FERC's approval precluded it from disallowing any portion of the wholesale rate. The New Hampshire Supreme Court reversed and remanded. It held that, while the preemption doctrine precluded the PUC from disapproving the wholesale rate (despite the state's anti-CWIP statute), the PUC was free to inquire into the reasonableness of CVEC's purchases from Cen. Vt. in light of other purchase options

available. The case was remanded to the PUC to make this inquiry. The Court also observed (Slip. Op., p. 2):

> The central question before the PUC in a retail rate case such as this is whether costs incurred under a wholesale rate, which has been approved as being a just and reasonable *charge* by the wholesaler, are just and reasonable *operating expenses* of the retail utility . . . The PUC never reached this question (Emphasis supplied by the Court).[27]

Accord, Pike County Light and Power Co. v. Pennsylvania Public Utility Commission, 77 Pa. Commw. Ct. 268, 465 A.2d 735 (1983). The NCUC's roll-in is similar to the Colorado and New Hampshire cases. The NCUC, in substance, determined that some of Nantahala's costs were imprudent in view of the alternatives available from the single system.

What most fundamentally separates the present case from the *Narragansett/Northern States* line, however, are the unique facts of this case. While some of the cases cited by the Appellants do involve cost allocations among the affiliated entities of a holding company system, in none of these cases do we find the circumstances of intercorporate abuse which are present here. See footnote 16, *supra.* These unique factual circumstances make *Narragansett/Northern States* and their progeny simply inapplicable to the present case.

---

[27] Interestingly, the *Sinclair* case is cited by EEI in its *Amicus Curiae* brief for the proposition that the issue of whether or not to pierce the corporate veil between affiliated utilities rests solely and exclusively with FERC (EEI brief, pp. 12-13). EEI has misread the *Sinclair* opinion. Properly viewed, the New Hampshire Court is merely observing the obvious—only FERC may decide whether to pierce the corporate veil in setting wholesale rates. This is clear, and clearly does not address the right of a State Commission to pierce the corporate veil in setting retail rates.

B. The Roll-in Is Not Barred by the Commerce Clause

For their final preemption argument, Appellants attempt to hide Alcoa's intercorporate abuses behind the Commerce Clause of the United States Constitution (Art. I, Sec. 8, Cl. 3) as applied in the case of *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982) (hereafter, "NEPCO"). They rely on NEPCO for the proposition that the roll-in, as applied by the NCUC, exclusively reserves North Carolina hydroelectric power produced by Nantahala and Tapoco for North Carolina ratepayers, in violation of the Commerce Clause. To the contrary, the roll-in methodology of setting rates merely allocates to the North Carolina retail jurisdiction its appropriate share of the costs of a single utility system operating in more than one state. None of the hydropower (or the economic benefits therefrom) is exclusively reserved to North Carolina.[28]

By its orders in this case, the NCUC has neither directly nor indirectly prohibited the export of electric power (or "economic benefits") from North Carolina. Not one word of the NFA or the 1971 Agreement has been changed. Not one electron of power of energy has been diverted. In contrast to NEPCO, the roll-in approved by the NCUC

---

[28] The Appellants (and their allies) have spared no opportunity to emphasize the NCUC's unfortunate misstatement to the effect that the roll-in methodology is based on the assumption that Nantahala's retail ratepayers are entitled to a preference (or "first call") on the total power and energy belonging to the single Nantahala-Tapoco system. (J.S., p. 9; App. pp. 182-183a). The opinion of the North Carolina Supreme Court (App. pp. 101-102a) clearly shows that Appellant's have taken the NCUC's statement out of context. If the NCUC had, in fact, awarded a "first call' or a preference to Nantahala's retail customers, Nantahala's rates would have been further reduced and the refunds required would have been even higher. By allocating "average" costs out of the Nantahala/Tapoco single system, the NCUC did not give a preference to anyone.

operates evenhandedly, on a two-way street. Assuming *arguendo,* that Appellants are correct (which Appellees do not concede) in their assertion that the roll-in shifts "economic benefits" away from Tapoco to Nantahala, the roll-in similarly shifts economic benefits from Nantahala to Tapoco. Specifically, Nantahala is allocated approximately 25% of the costs of the single Nantahala-Tapoco system (and, presumably, any attendant benefits). The other 75% are, by implication, allocated to Tapoco. In NEPCO, the process was a one-way street. New Hampshire received lower electric costs but did not give up anything. In addition, in NEPCO there was no predicate for holding the single-system stockholder/parent liable for its domination and abuse of its subsidiaries. NEPCO is no more relevant to the unique facts of this case than *Narragansett* or *Northern States.*

If applicable at all, NEPCO approves rather than forbids the NCUC's roll-in methodology. Were the argument of Appellants (and the State of Tennessee as *Amicus Curiae)* carried to its logical conclusion, we would have NEPCO in reverse. Appellants seek a result which would require *all* (not merely some) of Tapoco power from its Cheoah and Santeetlah (N.C.) dams to be exported to Tennessee, while at the same time requiring that *none* of Tapoco's power from its Chilhowee and Calderwood (Tenn.) facilities be allowed to leave Tennessee. It is Alcoa and its allies, not the Appellees, who are arguing in favor of economic protectionism.

The North Carolina Supreme Court acknowleged and distinguished NEPCO. It also held that any impact of the roll-in on interstate commerce is both incidental and negligible. As the North Carolina Supreme Court stated (App. pp. 105-106a):

Again, the roll-in, as employed by the Commission, does no more than establish the overall cost of operation of a single, unified Nantahala-Tapoco system and allocates the proper portion of those costs to North Carolina retail customers for the purpose of fixing just and reasonable rates for Nantahala. Such even-handed and traditional rate making operations do not implicate the national concern with 'economic protectionism' discussed in the BRUCE CHURCH[29] case. Moreover, the setting of retail electric rates for Nantahala's customers is clearly a legitimate North Carolina interest with a significant impact in this state. Not a word of the contracts or agreements properly regulated by FERC has been changed, and the fact that the price charged by Nantahala to its retail customers may have some *de minimis*, incidental effect on the price structure of the interstate 'grid' of which Nantahala is a part is not clearly excessive in relation to the substantial public interest in the establishment of just and reasonable electric rates for ultimate North Carolina consumers. See *Arkansas Elec. Coop. Corp. v. Arkansas Public Serv. Comm.*, 461 U.S. 375, 76 L.Ed. 2d 1. Accordingly, we conclude that the Commission's order does not impose an undue burden on interstate commerce and is not, therefore, prohibited by the Commerce Clause of the United States Constitution.

Appellants also argue that the outcome of this case is governed by the result in ***Middle South Energy, Inc. vs. Arkansas Public Service Commission,*** — F.2d — (Nos. 84-2409, *et al.*, 8th Cir., August 23, 1985). This case is similar to the two *Northern States Power Co.* cases, *supra*, except that the Eighth Circuit, in contrast to the State Courts, decided the case on the basis of the Commerce Clause, rather than federal preemption under Part II of the Federal Power Act. As we have previously shown, application of the preemption doctrine is improper here because the Orders of the NCUC, in setting retail rates for

[29] *Pike v. Bruce Church*, 397 U.S. 137 (1970).

Nantahala, do not conflict with the wholesale rate orders of FERC. The clear intent of the Arkansas PSC was to declare the FERC-mandated cost allocations of the Grand Gulf nuclear power station void *ab initio*. Here, the NCUC allowed all relevant costs arising from the NFA and the 1971 Apportionment Agreement into the *single system "pot" of costs*. Finally, the *Middle South* case did not involve parental abuse of the relationship between itself and its subsidiaries whereby the parent directly benefited, in its separate manufacturing operations, to the significant detriment of the subsidiary's customers. For these reasons, *Middle South* is simply inapplicable to the facts of this case.

The NCUC's purpose in ordering roll-in and holding Alcoa partly responsible for the refunds is to serve the important state interests of effectively regulating North Carolina public utilities and assuring just and reasonable rates for retail customers, free from the costs of imprudent, self-serving actions imposed on Nantahala by the self-dealing of its sole stockholder. Contrary to Alcoa's claims, the NCUC's retail rate order has neither an economic protectionist purpose nor an intent to regulate interstate commerce. Thus, the NCUC's orders serve legitimate and substantial local interests, with only incidental effects on interstate commerce, and they do not raise any substantial questions under NEPCO or the Commerce Clause.

o

CONCLUSION

Based on the specific and unique facts of this case, Appellees urge and contend that the NCUC order appealed from, as upheld by both the North Carolina Court of Appeals and the North Carolina Supreme Court, raises no

substantial federal questions because (1) the NCUC decision and the FERC decision are not in conflict and (2) this case does not involve a protectionist fight between North Carolina and Tennessee; it is a simple economic dispute between Nantahala's retail customers and the private, selfish interests of Nantahala's dominating parent, Alcoa. As a result, this Court should decline to note probable jurisdiction of the case. The Appeals should be dismissed and this Court should not review the case by way of Certiorari; alternatively, the judgment of the North Carolina Supreme Court should be affirmed *Per Curiam*.

Respectfully submitted, this the 19th day of November, 1985.

LACY H. THORNBURG
Attorney General

Richard L. Griffin
Assistant Attorney General
N. C. Department of Justice
Suite 207, Hayes & Hobson Bldg.
20 South Spruce Street
Asheville, North Carolina 28801
(704) 258-6083
Attorney for: The Using and Consuming Public

THE PUBLIC STAFF
ROBERT GRUBER
EXECUTIVE DIRECTOR

James D. Little
Staff Attorney
The Public Staff—North Carolina Utilities Commission
P. O. Box 29520
Raleigh, North Carolina 27626-0520
(919) 733-6110
Attorney for: The Using and Consuming Public

CRISP, DAVIS, SCHWENTKER, PAGE & CURRIN

William T. Crisp*
Robert F. Page
320 South Salisbury Street
P. O. Box 751
Raleigh, North Carolina 27602
(919) 833-2556
Attorneys for: Henry J. Truett, Counties of Cherokee, Graham, Jackson and Swain; Towns of Andrews, Bryson City, Dillsboro, Robbinsville and Sylva; and the Tribal Council of the Eastern Band of Cherokee Indians

*Counsel of Record

(9)

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,
Appellants,
v.

STATE OF NORTH CAROLINA EX REL.
UTILITIES COMMISSION; LACY H.
THORNBURG, Attorney General, *et al.*,
Appellees.

**On Appeal from the Supreme Court
of North Carolina**

REPLY TO MOTION TO DISMISS AND MOTION TO AFFIRM

REX E. LEE *
DAVID W. CARPENTER
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Appellants

Of Counsel:

RONALD D. JONES
DAVID R. POE
M. REAMY ANCARROW
LEBOEUF, LAMB, LEIBY & MACRAE

EDWARD S. FINLEY, JR.
WILLIAM D. JOHNSON
GRADY L. SHIELDS
HUNTON & WILLIAMS

* *Counsel of Record*

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

9PP

TABLE OF AUTHORITIES

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-568

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,
Appellants,
v.

STATE OF NORTH CAROLINA EX REL.
UTILITIES COMMISSION; LACY H.
THORNBURG, Attorney General, *et al.*,
Appellees.

On Appeal from the Supreme Court of North Carolina

REPLY TO MOTION TO DISMISS AND MOTION TO AFFIRM

Appellees seek to avoid review of the North Carolina Supreme Court's decision by contending that it rests on "unique facts" [1] and that appellants are somehow, *sub silento*, challenging four irrelevant factual findings of the NCUC.[2] These arguments are spurious. There is only one relevant fact here, and it is undisputed: the NCUC adopted a radically different allocation of inter-

---

[1] Motion to Dismiss and Motion to Affirm ("Motion"), pp. 1-11.

[2] *Id.* p. 13.

state wholesale power supplies and their costs between North Carolina and Tennessee than is prescribed by the governing FERC Rate Schedules and decisions.

Appellees ultimately admit that the North Carolina Supreme Court upheld the NCUC on the ground that, despite the Federal Power Act, state commissions can investigate interstate wholesale power transactions and cost allocations regulated as FERC rate schedules, and can disregard them whenever the state commission finds that the costs allocated to the State by FERC were not "reasonably incurred to serve [retail customers in that State]." Motion p. 22. This holding squarely conflicts with the decisions in *Northern States Power Co.* v. *Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn.), *cert. denied*, 104 S. Ct. 3546 (1984) and numerous other cases.[3] It also threatens the orderly, uniform regulation of interstate energy transactions envisaged by the Federal Power Act, and thereby jeopardizes important interests of the federal government, the electric power industry, and the nation.

Each of the appellees' other arguments is an attempt to divert attention from the central fact that, contrary to the Federal Power Act, North Carolina has disregarded FERC's regulation for the only purpose that really matters.

1. Appellees' principal argument is that state ratemaking authorities can "roll-in" two or more affiliated electric utilities and treat them as a single system for ratemaking purposes. Whatever the merits of that question, it is not presented here. The decisive fact is that the FERC wholesale rate schedules and decisions allocate Nantahala's and Tapoco's costs of obtaining power for the service they provide in North Carolina and Tennessee, respectively. And the NCUC has candidly admitted that its "roll-in" method was "nicely suited [illegible] proper alternative to reformation of contracts" (App. 202a) regulated by FERC as wholesale rate schedules. The Federal Power Act, as consistently interpreted, prohibits North Carolina from adopting a different allocation of those costs that is more favorable to its citizens. This principle has special force here, for the North Carolina Attorney General participated on behalf of Nantahala's *retail* customers in the FERC proceedings in which those customers unsuccessfully sought to have FERC adopt different allocations.

[3] *Northern States* held that state retail ratemakers must recognize plant abandonment costs as allocated by FERC between two companies. Because there was no benefit to Minnesota ratepayers from an abandoned plant, *Northern States* clearly would have been decided the other way under the North Carolina Supreme Court's test. See Jurisdictional Statement, pp. 14-20.

2. The contention that there is no conflict between the NCUC order and FERC's regulation is simply wrong. It rests, ultimately, on the appellees' assurance, taken from the North Carolina Supreme Court's opinion, "that not a word of the contracts or agreements properly regulated by FERC has been changed."[4] But this misses the point. North Carolina has ignored FERC's allocations and kept for itself some $45 million more of low cost power than FERC determined it was entitled to keep.[5]

Indeed, appellees' arguments, by their terms, are attacks on the FERC rate schedules and decisions. Most of their brief is devoted to claims that "unique facts" dating back to 1900 somehow make the NCUC's allocation of 92.7 megawatts of low-cost capacity entitlements to North Carolina more fair than the 54.3 megawatts allocated by FERC's Nantahala Rate Schedule No. 1. Appellees insist, in this regard, that the NCUC's higher allocation was justified by "the corporate abuses which the NCUC found among three affiliated North Carolina

[4] Motion p. 28, quoting from App. 105a.

[5] Jurisdictional Statement, p. 12.

public utilities . . . ."[6] The short answer is that that precise issue—whether Alcoa's alleged domination should affect its share of NFA entitlements—was considered and decided against the appellees by FERC.[7] Appellees are thus reduced to making the astonishing assertion that FERC "inexplicably" does not understand its own order.[8]

Verbal characterizations aside, there are enormous differences in the results reached by the federal and state commissions. If North Carolina is free to serve its own selfish interests as it has done in this case, and others,[9] so is every other state. Fortunately, the Federal Power Act as interpreted by other state supreme courts—and by the agency charged with its enforcement—preempts such a consequence.[10] The FPA permits states to set retail rates, but when they do so, they must recognize FERC-determined wholesale costs and power supply allocations as recoverable expenses.

3. The argument that there is no Commerce Clause violation is also spurious. The NCUC's order is not "traditional ratemaking," and does not allocate 25% of the power to North Carolina and 75% to Tennessee.[11] Rather, the NCUC order requires an increase in North Carolina's share of the cheap hydroelectric power, and a corresponding decrease in Tennessee's share, whenever the needs of North Carolina's retail customers increase.[12] The NCUC order thus epitomizes the kinds of explicit economic protectionism for local interests that would violate the Commerce Clause even if the Federal Power Act did not exist. *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982).

4. The assertions that the facts are unique to this case and that there are no issues of national importance are nothing less than startling. The appellees assure the Court that "this case does not involve a jurisdictional dispute between North Carolina and Tennessee" [13] Tennessee disagrees.[14] The appellees represent that "the final result reached in this case cannot be extended to the electric power industry generally." [15] The electric power industry disagrees.[16] Finally, the appellees state that

---

[6] Motion p. 14. The status of Alcoa and Tapoco as North Carolina "public utilities" is irrelevant to the preemption and commerce clause principles that control this case. Tapoco supplies power only to the Alcoa operations in Tennessee.

[7] See Jurisdictional Statement, pp. 7-8 and App. 291a, 293a-295a.

[8] Motion, p. 18, n. 19.

[9] In subsequent cases, the North Carolina Supreme Court has ordered this same method of allocating power between Nantahala and Tapoco/Alcoa to continue indefinitely. *North Carolina ex rel. Util. Comm'n* v. *Nantahala Power and Light Co.*, 314 N.C. 246, 333 S.E.2d 217 (1985); *North Carolina ex rel Util. Comm'n* v. *Edmisten*, 314 N.C. 122, 333 S.E.2d 453 (1985).

[10] For reasons developed in the Jurisdictional Statement and the amici briefs, the North Carolina Supreme Court decision squarely conflicts with *Narragansett Electric Co.* v. *Burke*, 381 A.2d 1358 (1977), *Northern States Power Co.* v. *Minnesota Public Utilities Commission*, *supra* and other state supreme court cases on the preemption issue. It is irrelevant that *Narragansett* itself and other decisions hold that increased costs under FERC wholesale rate schedules need not *automatically* be passed through to retail ratepayers under fuel adjustment clauses, in view of the possibility of offsetting savings in other parts of the local utility's business. The *Narragansett* opinion clarifies that while the "PUC [need not] automatically adjust the retail rates," it must do what the NCUC refused to do: "no matter what method it adopts [the PUC] must treat the [FERC] filed and-bonded purchase . . . as an actual operating expense." 381 A.2d at 1363.

[11] Compare Motion, p. 27.

[12] Jurisdictional Statement, pp. 9-12 & nn. 14-15.

[13] Motion, p. 10, n. 15.

[14] Amicus brief, State of Tennessee.

[15] Motion, p. 11.

[16] Amicus brief, Edison Electric Institute.

"FERC thus recognized that . . . the NCUC['s] exercise of retail ratemaking authority does not conflict with FERC's decision.[17] FERC disagrees.[18]

CONCLUSION

It cannot be seriously contended that the federal questions presented are anything but substantial. Agreement on that issue reaches from the North Carolina Supreme Court to the Federal Energy Regulatory Commission. Probable jurisdiction should be noted so that the substantial federal questions can be considered by a federal court.

Respectfully submitted,

REX E. LEE *
DAVID W. CARPENTER
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Appellants

Of Counsel:

RONALD D. JONES
DAVID R. POE
M. REAMY ANCARROW
LEBOEUF, LAMB, LEIBY & MACRAE

EDWARD S. FINLEY, JR.
WILLIAM D. JOHNSON
GRADY L. SHIELDS
HUNTON & WILLIAMS

* *Counsel of Record*

Dated: November 27, 1985

---

[17] Motion, p. 16.

[18] Amicus brief for the United States and FERC.

(3)

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,
Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, *Attorney General, et al.*,
Appellees.

On Appeal from the Supreme Court of North Carolina

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* AND BRIEF OF EDISON ELECTRIC INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF THE JURISDICTIONAL STATEMENT

ROBERT L. BAUM
Counsel of Record
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-7400

RICHARD M. MERRIMAN
ROBERT S. WATERS
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-0100

Attorneys for Edison Electric Institute

Of Counsel:

REID & PRIEST

October 1985

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

30 p

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No.

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,
Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, *Attorney General, et al.,*
Appellees.

On Appeal from the Supreme Court of North Carolina

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

Pursuant to Rules 36 and 42 of the Rules of the United States Supreme Court, the Edison Electric Institute (EEI) respectfully moves for leave to file the attached brief as *amicus curiae.*[1]

---

[1] While some parties have consented to the filing of the attached brief as *amicus curiae,* various other parties have not consented to EEI's participation. The letters providing consent have been filed with the Clerk of the Court.

SPECIAL INTEREST OF EDISON ELECTRIC INSTITUTE

EEI is the national association of investor-owned electric utility companies in the United States. EEI's members, in significant contrast to the Aluminum Company of America (Alcoa), obtain substantially all, if not all, their operating revenues and income from sales of electricity to consumers at rates regulated by state commissions (or local regulatory bodies) and the Federal Energy Regulatory Commission (FERC). At the retail level, EEI's members conduct their businesses in accordance with the broad duty of public utilities to serve the public.

Central issues in the decision below involve the relationship, consistent with federal preemption doctrine, between the separate powers of the FERC and the North Carolina Utilities Commission (NCUC) to regulate electric rates, and limitations imposed by the Commerce Clause of the United States Constitution on the power of the state of North Carolina to regulate the economic benefits of hydroelectric power generated within its borders. These issues are vitally important to electric utility companies and their customers, and the final opinion in the case may become a significant and far-reaching precedent.

Alcoa owns two companies which generate electric power within the state of North Carolina for sale in interstate commerce. These companies were parties to the rate proceedings before the NCUC giving rise to this case. Unlike EEI's member companies, however, Alcoa is not primarily in the business of owning properties to generate electricity for sale to the public pursuant to federal and state rate regulation. Instead, Alcoa obtains practically all its revenues and income from the

production and sale of aluminum products. Since the production of aluminum requires large amounts of electric power, Alcoa is principally a consumer of electricity, not a producer.

Therefore, EEI is in a unique position to approach the issues from the perspective of electric utilities and their customers, which have a vital interest in the outcome. The attached brief as *amicus curiae* demonstrates that the questions arising in the case are substantial and may seriously affect the regulatory domain of electric utilities and their customers.

CONCLUSION

For the reasons set forth above and in the attached brief, EEI urges the Court to grant its motion for leave to file the attached brief as *amicus curiae*.

Respectfully submitted,

ROBERT L. BAUM
Counsel of Record
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-7400

RICHARD M. MERRIMAN
ROBERT S. WATERS
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-0100

Attorneys for Edison Electric Institute

Of Counsel:

REID & PRIEST

October 1985

QUESTIONS PRESENTED

Whether a decision of the North Carolina Utilities Commission violates federal preemption by requiring an allocation of power supply costs incurred pursuant to rate schedules subject to regulation under the Federal Power Act in a manner different than that found just and reasonable by the Federal Energy Regulatory Commission.

Whether the same decision violates the Commerce Clause of the United States Constitution insofar as it gives retail electric customers located in North Carolina a preference over an out-of-state customer to the economic benefits of hydroelectric power generated within North Carolina.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No.

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,
Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, *Attorney General, et al.,*
Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF EDISON ELECTRIC INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF THE JURISDICTIONAL STATEMENT

PARTIES TO THIS PROCEEDING

The parties to this proceeding are set forth in the Jurisdictional Statement.

OPINION BELOW

The opinion below is reproduced in the Appendix to the Jurisdictional Statement and reported at 313 N.C. 614.

JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. § 1257(2) (1982).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The constitutional provisions involved are reproduced in the Jurisdictional Statement and the statutory provisions involved are reproduced in the Appendix to the Jurisdictional Statement.

INTEREST OF EDISON ELECTRIC INSTITUTE

Edison Electric Institute (EEI) is the national association of investor-owned electric utility companies in the United States. Its members serve approximately 96 percent of all customers of the investor-owned segment of the electric utility industry and 73 percent of the nation's electricity users.

Many EEI members obtain a portion of their total supply of electrical capacity and energy (power) available to sell to their retail customers through interstate, wholesale purchases from other utilities or from generating companies at rates regulated exclusively by the Federal Energy Regulatory Commission (FERC). For example, some EEI members have entered into wholesale purchase agreements with neighboring utilities. Additionally, a significant number of EEI's members participate in interstate, multiparty power pools which include provisions for reciprocal wholesale sales and exchanges of power; others have invested in electrical generation projects that are jointly owned by utilities with separate retail service areas. These baseload, generating projects also typically involve large, wholesale sales of power.

In these arrangements, ratemaking jurisdiction almost always rests first with the FERC and then with at least one state commission (or local agency) which establishes the retail rates that are necessary to pass through the costs of the wholesale supplies to the ultimate consumers. More than one state commission will be interested in the wholesale arrangement if there are several purchasers with service areas in different states. Therefore, many EEI member companies are exposed to a blend of regulation that includes the FERC and at least one state commission but, quite possibly, may include two or more state commissions. This blend of regulation has created serious ratemaking conflicts.

The amount of power available for retail consumers that is supplied by arrangements involving wholesale purchases is enormous and will continue to increase. The costs associated with the largest of these wholesale arrangements, which sometimes have expected durations of approximately 30 years, may be measured in billions of dollars, and the planning involved to complete large projects consumes many years. The allocation of responsibility for these costs will be affected by any significant decision involving the reconciliation of federal and state utility ratemaking jurisdictions or the power of a state to regulate the economic benefit of power resources within its borders.

STATEMENT OF THE CASE

EEI adopts the Statement of the Case presented in the Jurisdictional Statement.

I. The Questions Presented Are Substantial.

In recent years as the costs associated with interstate, wholesale purchases have risen dramatically, im-

portant questions concerning the reconciliation of the FERC's wholesale ratemaking jurisdiction under Part II of the Federal Power Act, 16 U.S.C. § 824-824k (1985) (the Act), with the role of state or local regulatory agencies already have been presented in various regions of the nation and undoubtedly will be addressed in the future in other regions. Resolution of these questions will affect the manner in which costs are distributed among different groups of customers, who will be taking service in many instances from utilities located in different states and subject to the retail ratemaking authority of different regulatory bodies.

In the case below, the Supreme Court of North Carolina has determined that, for the purpose of establishing retail rates, the North Carolina Utilities Commission (NCUC) was not preempted from adopting its method for allocating wholesale power costs between customers in the states of North Carolina and Tennessee in a manner different from that allocated by the FERC in establishing wholesale rates, nor was the NCUC's order unduly burdensome on interstate commerce in violation of the Commerce Clause of the United States Constitution. U.S. Const., art. I, § 8, cl. 3 (the Commerce Clause). The court correctly stated that the decision involves "substantial questions under the federal constitution." 313 N.C. at 624.

Left standing as is, the decision threatens the ability of utilities purchasing bulk power supplies under rates set by the FERC to obtain or maintain stable and rational cost allocation plans at the state level. This situation will be particularly acute when ratemaking jurisdiction is not only divided between the FERC and a state commission but instead, among the FERC and more than one state commission. Furthermore, the decision could jeopardize attempts to plan and finance interstate power projects and power pooling agreements that may be needed in the future to meet expected load growth.

II. The Decision Below Is Inconsistent With Preemption Doctrine.

The center of the controversy in this appeal is the NCUC's choice of a method of cost allocation used to establish rates applicable to general retail service provided by Nantahala Power and Light Company (Nantahala) and the effect of that choice on rates applicable to service of a customer in another state. Nantahala and Tapoco, Inc. (Tapoco) are wholly-owned subsidiaries of the Aluminum Company of America (Alcoa), and both are public utilities under the Act. Nantahala and Tapoco are parties to the "New Fontana Agreement" (the NFA) and the "1971 Nantahala-Tapoco Apportionment Agreement" (the 1971 Apportionment Agreement), which together constitute rate schedules subject to the FERC's exclusive rate jurisdiction under the Act (collectively, the Agreements). The FERC-regulated rate schedules provide for Nantahala and Tapoco to deliver certain hydroelectric power to the Tennessee Valley Authority (TVA), and to receive in return certain entitlements to power, that are then apportioned between Nantahala and Tapoco.

Since Nantahala and Tapoco are separate corporations, they have separate generating facilities and separate costs of owning and operating those facilities. Likewise, the power apportioned to each in return for the exchange with TVA is separately recorded as part of each company's own resources. Thus, as recorded on their separate books of accounts, Nantahala and Ta-

poco have their own costs of service. Furthermore, Nantahala's cost of service traditionally has been separately allocated in accordance with authorized methods of allocation in wholesale and retail rate cases before the FERC and the NCUC among the different classes of service provided by the company.

Under the method adopted by the NCUC in the case below, however, Nantahala and Tapoco were first rolled together and a single, combined cost of service was derived. Then, contrary to the request of Nantahala and Tapoco to use a method of allocating this combined cost of service that used the entitlements, and apportionment of such entitlements, as established by the Agreements, the NCUC chose a method of allocation which purportedly assigned cost responsibility to Nantahala and Tapoco "on the basis of which load actually used the capability available from the generating facilities of the combined system." 313 N.C. at 667.[1] The effect of using this method, referred to generally as the "roll-in" method by the lower court, was to produce a lower cost responsibility for Nantahala's general service customers, all of whom are located in North Carolina, and a higher cost responsibility for Tapoco, which only serves Alcoa's industrial load in the state of Tennessee.

As the lower court recognized, objection to the NCUC's decision to use the so-called roll-in method

[1] The lower court's description of the method of allocation chosen by the NCUC is misleading. Due to the inherent characteristics of electricity flowing in a transmission grid, it is impossible to know which loads actually used which capability. *FPC* v. *Florida Power and Light Co.*, 404 U.S. 453 (1972). *Accord, New England Power Co.* v. *New Hampshire*, 455 U.S. 331, 334 (1982). Thus, the relevant point is that the NCUC chose a different method of cost allocation than one consistent with the Agreements.

lies not only with the roll-in itself but with the related cost allocation method used to apportion the combined costs between Nantahala and Tapoco. 313 N.C. at 667.[2] For example, as asserted by the appellants, the worst aspect of the NCUC's cost allocation method is its use of an assumed level of entitlements that exceed actual entitlements under the NFA. Jurisdictional Statement at 10-11. The important and undisputed point for the purpose of this brief is that the NCUC's method did not follow the FERC-regulated rate schedules in choosing a cost allocation method; therefore, cost responsibility was reallocated between Nantahala and Tapoco.

The roll-in method adopted by the NCUC is directly contrary to determinations made when the FERC considered a request for use of a roll-in method in a hearing conducted pursuant to the FERC's exclusive jurisdiction over the Agreements. *Nantahala Power and Light Co.*, Opinion No. 139, 19 F.E.R.C. ¶ 61,152 (1982), *aff'd, Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984). While the FERC adjusted the level of entitlements apportioned to Nantahala and Alcoa under the 1971 Apportionment Agreement, it did not adjust the NFA. Moreover, it expressly rejected a roll-in method because the "separate corporate identities of Nantahala and Tapoco . . . [did not] . . . frustrate the purposes of the Federal Power Act." *Id.* at 61,277.

In its opinion, the North Carolina Supreme Court recognized that the Agreements fall within the "regulatory jurisdiction of the FERC under Part II of the

[2] However, Alcoa alleges that the NCUC used only a partial roll-in which, by assigning responsibility for a higher cost purchase by Alcoa from TVA under a separate agreement entirely to Alcoa, has the effect of biasing the process in favor of Nantahala.

Federal Power Act" (313 N.C. at 684) and that, "the North Carolina Utilities Commission is preempted from directly or indirectly regulating the wholesale rate structure created by the New Fontana and 1971 Apportionment Agreements or inquiring into the reasonableness of those FERC-filed wholesale rate schedules when it acts in fixing Nantahala's retail rates." *Id.* at 687. To avoid the obvious problem with established principles of preemption as applied to utility ratemaking,[3] the lower court made a distinction between approving any effort on the part of the NCUC to "reform the contracts [the Agreements] to alter the actual flow of return power [from TVA] thereunder," which it recognized would be patently unlawful, and merely permitting the NCUC to exercise discretion in "choosing between the competing jurisdiction cost allocation methodologies presented by the parties." *Id.* at 668-669.[4]

Despite the distinction drawn by the lower court, the roll-in method which it approved does produce a different allocation of entitlements to the TVA power for Nantahala and Tapoco than the allocation made by the FERC. The NCUC implicitly recognized the actual nature of its decision when it stated, candidly, that there was no need to reform the NFA because the

[3] As applied to utility ratemaking, preemption is frequently referred to as the "Naragansett Doctrine," after the often cited case of *Naragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

[4] Similarly, in an overly defensive statement, the North Carolina Supreme Court observed that "nothing contained in the Commission's order *purports* to change or modify a single word of the . . . agreements involved, or the actual flow of power thereunder." 313 N.C. at 688 (emphasis added).

roll-in method was "an alternative solution available" which could be used to rectify the "inequities" in the entitlements created by the Agreements.[5] The lower court's distinction amounts to a legal fiction conceived solely to avoid a collision with preemption doctrine as set forth in its opinion.

Furthermore, the North Carolina Supreme Court's analysis of the preemption cases brought to its attention is faulty and misleading in its emphasis. First, before analyzing the three most factually similar cases, the court concluded that there exists a preemption rule of general applicability to utility ratemaking which is consistent with the NCUC's decision. As stated by the court, the preemption rule "requiring state commissions to 'treat' costs based upon FERC-filed rates as reasonably incurred operating expenses, thus preventing the automatic disallowance of these costs, has not been held to preclude state authority to determine whether these costs should be automatically passed through to retail consumers in the form of higher rates." 313 N.C. at 693-694.

The court's statement of a preemption rule strains the meaning of the cases from which it is derived.[6] More significantly, the court failed to recognize that those cases involve factual situations significantly dis-

[5] *In the Matter of Application of Nantahala Power and Light Company for Authority to Adjust and Increase Its Electric Rates and Charges*, NCUC Docket No. E-13, SUB 29 [Remanded], *Order Reducing Rates and Requiring Refund*, Mimeo at 22 (Oct. 3, 1980). See Appendix to Jurisdictional Statement.

[6] The cases, beginning with *Naragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978), are discussed by the lower court at 313 N.C. 693-696.

similar to the case below. None of those cases called into question a decision on the part of a state commission to allocate power supply costs between two utilities in a manner different from a plan of allocation found just and reasonable by the FERC pursuant to its authority under the Act.[7]

Second, after shaping a narrow preemption rule on the basis of cases within a limited factual range, the court incorrectly found that the cases "upon which Nantahala and Alcoa place principal reliance . . . do not lead to a different conclusion." 313 N.C. at 696-697. Its attempt to distinguish the two *Northern States* cases, *Northern States Power Co.* v. *Minnesota Pub. Util. Comm'n,* 344 N.W.2d 374 (Minn.), *cert. denied* 104 S.Ct. 3546 (1984) and *Northern States Power Co.* v. *Hagen,* 314 N.W.2d 32 (N.D. 1981), is contrivance rather than correct reasoning. In both cases, state commissions failed to pass through in the form of higher retail rates the costs of an abandoned power generation project that had been allocated pursuant to a FERC-regulated rate schedule to utilities subject to their retail rate jurisdictions. The supreme courts of both states reversed the orders of their respective state commissions, as the lower court itself stated, "on the ground that the reasonableness of a . . . wholesale rate filed and approved by FERC cannot be relitigated in a retail rate proceeding before a state utilities commission." 313 N.C. at 697.

---

[7] Indeed, two of the cases involve research and development expenditures rather than costs attributable to power generation. *Pub. Serv. Co. of Colorado* v. *Pub. Util. Comm'n of Colorado,* 644 P.2d 933 (Colo. 1982), and *Washington Gas Light Co.* v. *Pub. Serv. Comm'n of the District of Columbia,* 452 A.2d 375 (D.C. App. 1982), *cert. denied,* 462 U.S. 1107 (1983).

The court implicitly recognized that the *Northern States* cases, involving a cost allocation plan established by the FERC for a power generation project, are directly on point. Plainly in an effort to protect retail ratepayers within North Carolina from higher rates at the expense of an out-of-state ratepayer, however, the court contrived the distinction that such cases prohibit only a direct disallowance of costs allocated according to a FERC-regulated rate schedule, whereas the NCUC "did not disallow any of the system costs incurred by both Nantahala and Tapoco under the NFA and 1971 Apportionment Agreement in determining the aggregate rate base and operating expenses of the rolled-in system." 313 N.C. at 698. Elaborating, the court stated that, "*all costs* attributable to Nantahala and Tapoco were *recognized and allowed* by the roll-in; the difference between 'book' costs and 'reasonable' costs resulting from the Commission's discretionary determination that only a certain percentage of Nantahala's book costs were incurred in serving the combined system's intrastate retail customers." *Id.* at 698.

Irrespective of the court's view, it is inescapable from the point of view of Nantahala that some of its "book" costs of power generation allocated to it pursuant to the FERC-regulated Agreements were disallowed by the NCUC. Thus, as a result of the so-called roll-in method, Nantahala's retail customers, all of whom are located in North Carolina, will not pay for Nantahala's production and purchased power costs in the same proportion that they would have if the NCUC had respected the FERC-regulated Agreements; and Alcoa's plant in Tennessee will incur responsibility for the difference.

If Tapoco were located just across the state line in Tennessee and both it and Nantahala were owned by a parent company which, unlike Alcoa, derived substantially all its revenues from their retail rates, the result of this cost shifting could be more disastrous. If Tennessee's state commission, exercising its jurisdiction over Tapoco's retail rates,[8] made a similar "discretionary determination that only a certain percentage of [Tapoco's] book costs were incurred in serving the combined system's intrastate retail customers," the two utilities and their parent would be caught in the middle, as neither utility would be allowed to recover its cost of service. The FERC lacks the power to order state commissions to permit recovery through retail rates of FERC-approved wholesale rates. Therefore, absent protection by the courts through enforcement of a sound preemption rule, the ability of Nantahala and Tapoco to render service to their customers would be impaired.

The court relied on the observation that all production costs attributed to a combined Nantahala-Tapoco system "were *recognized* and *allowed*" to avoid the problem of cost shifting caused by the NCUC's order. That reliance is dependent in large part on the validity of the lower court's determination to "pierce the corporate veil" and treat the two affiliated companies as one. However, with regard to a case involving the pass through of power generation costs between two affiliated utilities pursuant to a FERC-regulated rate schedule, the Supreme Court of New Hampshire recently found that the issue of piercing the corporate veil is "within the FERC's domain of fixing the whole-

[8] More typically, Tapoco might have a mix of customers similar to Nantahala's.

sale rate between these parties." *Sinclair Machine Products, Inc.* v. *Pub. Util. Comm'n of New Hampshire,* No. 84-380 (N.H. July 26, 1985) at 12. The court also found that the "modern trend"[9] in applying the preemption doctrine to state regulation of retail electric rates is to preempt the state from considering matters actually determined, whether expressly or impliedly, by the FERC. *Id.* at 7. As discussed, the FERC, in deciding not to adopt a roll-in method, expressly rejected the argument that it should pierce the corporate veil between Nantahala and Tapoco.[10]

The lower court's treatment of *Office of Pub. Counsellor* v. *Indiana and Michigan Electric Co.,* 416 N.E.2d 161 (Ind. App. 1981) is also unconvincing. Here again,

[9] The court's reference to a "modern trend" reflects some decisions in lower courts and various regulatory agencies which may be perceived as creating an exception to the rule requiring a state commission to treat FERC-regulated rates as reasonable expenses. *Id.* at 7. *See, e.g., Pike County Light and Power Co.* v. *Pennsylvania Pub. Util. Comm'n,* 465 A.2d 735 (Pa. Commw. Ct. 1983). The exception, if valid, would permit a state commission to consider the prudence of a utility's decision to make a purchase under FERC-regulated rates in light of other power supply options available to the utility. The decision below does not expressly or impliedly turn on an exception, if any, of this type because the prudence of Nantahala's power supply arrangements is not questioned.

[10] *Accord, United Gas Corp.* v. *Mississippi Pub. Serv. Comm'n,* 240 Miss. 405, 127 So.2d 404 (1961), wherein the Supreme Court of Mississippi rejected the view of the state's retail ratemaking commission that, because the interstate and intrastate companies were affiliated, the commission could disregard the FPC [predecessor to the FERC] rates. ("There is nothing to suggest that the FPC will not closely scrutinize this relationship, for the statutory purpose of protecting the public and consumers from exploitation.")

the case involves an allocation of power generation costs pursuant to a FERC-regulated rate schedule in the context of a retail rate proceeding before the appropriate state commission. Moreover, the device used by the state commission to alter the level of costs allocated pursuant to the FERC regulated rate schedule was a roll-in of the generation resources of two separate corporate identities. The Indiana Court of Appeals struck down the state commission's roll-in, as summarized by the court below, because it constituted "an impermissible collateral attack on the authority of the FERC." 313 N.C. at 699.[11] Once more, however, the lower court offered the faulty explanation that the NCUC's roll-in was different because it did not result in a disallowance of Nantahala and Tapoco's combined generation costs. Then, it stated that, "Moreover, it is obvious that the 'roll-in' attempted by the Indiana Commission entailed a far more direct intrusion into FERC's regulatory domain . . . ." *Id.* at 700.

The lower court's statement carries the implication that the NCUC has intruded on the FERC's authority. The court's distinction between a "far more direct intrusion" and presumably an intrusion of ordinary dimensions should not be accepted. ***Federal Power Comm'n* v. *Southern California Edison Co.*,** 376 U.S. 205, 215-216 (1964). ("Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction making unnecessary . . . case-by-case analysis.") Regardless of the lower court's subjective view of the degree of severity, federal preemption precludes that intrusion.

---

[11] ***Accord, Sinclair Machine Products,*** No. 84-380 (N.H. July 26, 1985).

Furthermore, the lower court's rejection of federal preemption arguments on the grounds that the FERC itself adjusted the 1971 Apportionment Agreement (313 N.C. at 693, 703-710) is plainly poor reasoning; and in finding the NCUC's "ratemaking methodology to be consistent with FERC's own actions in the parallel wholesale rate case" (*Id.* at 703), the court took much liberty since the FERC did not adopt anything resembling the NCUC's cost allocation method. The FERC's modification of the allocation plan embodied in the 1971 Apportionment Agreement represents a proper exercise of its authority under the Act to ensure that rate schedules subject to its jurisdiction are just and reasonable. By carrying out that duty, the FERC did not open the way for the NCUC to bypass the doctrine of federal preemption; otherwise, federal preemption would become an intolerable constraint under the FERC in attempting to perform its duties. In any event, although the FERC did adjust the 1971 Apportionment Agreement, the adjustment made by the FERC is radically different from the NCUC's cost allocation method.

In summary, in finding that the NCUC's order did not violate federal preemption, the decision of the North Carolina Supreme Court is inconsistent with preemption doctrine as applied by the supreme courts of the states of Minnesota and North Dakota and by the state of Indiana's court of appeals in cases far more similar to the case below than any other preemption cases decided by courts to date. If allowed to stand, the decision could imperil the electric utility industry's reliance on FERC-regulated power supply contracts to meet large portions of the nation's demand for electrical power.

III. The Decision Below Violates The Prohibition Against Undue Interference With Interstate Commerce.

Unlike precedent on the preemption issue, which so far has been crafted by lower courts, precedent on the relationship of the Commerce Clause to the power of states to regulate the economic benefits of hydroelectric power flowing in interstate commerce is "well-settled," *Middle South Energy, Inc.* v. *Arkansas Pub. Serv. Comm'n,* Nos. 84-2409, 84-2410 and 84-2480, slip op. at 12 (8th Cir. August 23, 1985) because this Court has spoken. *New England Power Co.* v. *New Hampshire,* 455 U.S. 331, 344 n.10 (1982) (deferring resolution of preemption issue in favor of resolving Commerce Clause issue). Therefore, unlike its analysis of the preemption issue, in which the lower court was able to confuse the most significant precedent with precedent derived from similar but less meaningful circumstances, the lower court's analysis of the NCUC's decision in light of the Commerce Clause implicitly recognizes that one case, *New England Power Co.,* (*NEPCO*), controls. The court stated:

> We agree with the companies' contention that *NEPCO* establishes that a state utilities commission may not grant its citizens a preferred right to the benefit of hydroelectric energy generated by a utility in that state solely to gain an economic advantage over the utility's out-of-state customers, and that the granting of such a preferred benefit, regardless of how it is effectuated, places a direct and substantial burden on interstate commerce in violation of the Commerce Clause.

313 N.C. at 710.

In not agreeing with the assertion "that the rule announced in *NEPCO* invalidates the action of the Com-

mission in this case" (*Id.* at 710), however, the lower court resorted to the same, superficial form of distinction it drew with respect to the *Northern States* cases and *Office of Public Counsellor* v. *Indiana and Michigan Electric Co.* The court noted:

> However, unlike the action of the New Hampshire commission, the roll-in performed by the Commission in this case does not *purport* to prohibit the exportation of energy produced within North Carolina, nor does it divert the flow of Tapoco's power to Nantahala. More importantly, the roll-in methodology used by the Commission does not exclusively reserve to the citizens of North Carolina the entire economic benefit of the unified system's low-cost in-state hydroelectric generation.

313 N.C. at 712-713 (emphasis added).

The court's reliance on its interpretation of the New Hampshire Commission's order as purporting to prohibit the exportation of hydroelectric power produced within New Hampshire is insufficient. In *NEPCO,* this Court decided the Commerce Clause issue knowing that, "[t]he Commission did not, however, order New England Power to sever its connections with the Power Pool." *NEPCO* at 336. Moreover, *NEPCO* is clearly premised on recognition that:

> So long as the electricity produced at New England Power's hydroelectric plants continues to flow through the Pool's regional transmission network, it will be impossible to contain that electricity within the State of New Hampshire in any physical sense. Although the precise contours of the Commission's order are unclear, it appears to require that New England Power sell electricity to New Hampshire utilities in an amount equal to the output of its in-state hydroelectric facilities, at

> special rates adjusted to reflect the entire savings attributable to the low-cost hydroelectric generation.

Id. at 336 (footnote omitted).

Thus, although the order of the New Hampshire Commission was cast in terms of prohibiting the export of hydroelectric power outside the state, *NEPCO* invalidates "protectionist regulation" (*Id.* at 339) taking the form of special rates as well as an order overtly blocking the flow of interstate commerce at a state's borders.

Indeed, finding *NEPCO* dispositive, the United States Court of Appeals for the Eighth Circuit recently affirmed the judgment of the district court enjoining the Arkansas Public Service Commission (APSC) from even continuing a show cause proceeding, aimed at protecting the citizens of Arkansas from a wholesale rate increase, although the state's attorney general argued that there was no significant burden on interstate commerce because "the APSC has only issued a show cause order, and not actually voided the contracts in issue." *Middle South Energy, Inc.* v. *Arkansas Pub. Serv. Comm'n,* Nos. 84-2409, 84-2410 and 84-2480, slip op. at 13 (8th Cir. August 23, 1985). Furthermore, while the APSC sought to cancel agreements at issue "ostensibly because they have not received the necessary state regulatory approval," the court saw that the APSC's actual concern was economic protection of its citizens and that this protection was to be achieved at the expense of citizens of other states. *Middle South Energy,* slip op. at 22-23 ("Given free rein, the APSC would shift this burden [wholesale rate increase pursuant to the Act] to the citizens of Mississippi and Louisiana, citizens who are powerless to directly influence Arkansas' internal affairs.") In this case, it is also "abundantly plain" (*Id.,* slip op. at 22) that the NCUC's concern is to protect Nantahala's general service customers by shifting the burden of a rate increase to another state.

The lower court also fails in its attempt to distinguish *NEPCO* on the ground that the NCUC's cost allocation method "does not exclusively reserve to the citizens of North Carolina the entire economic benefit of the unified system's low-cost in-state hydroelectric generation." The NCUC characterized the cost allocation method chosen by it as one which assumed that Nantahala's public load had a "first call on the total electric energy output of the combined Nantahala-Tapoco system." 313 N.C. at 714. The court contends, however, that a complete reading of the NCUC's order shows that the NCUC's "initial characterization" of its method as creating a "first call" was in error. *Id.* at 715. Accepting the court's interpretation of the NCUC's order for the sake of argument, the fact remains that, for the reason explained in the Jurisdictional Statement,[12] the order has the effect of giving Nantahala's customers a first call on the cheaper hydroelectric power. In turn, this requires Tapoco to take more expensive power to serve Alcoa's plant in Tennessee.

The order is, therefore, an act of simple economic protectionism that is *per se* unlawful under *NEPCO.* The lower court's attempt to characterize the NCUC's order as "even-handed" regulation of the type upheld in *Arkansas Electric Cooperative Corp.* v. *Arkansas Pub. Serv. Comm'n,* 461 U.S. 375 (1983), is inadequate.

[12] As explained therein, the operative factor is the use of assumed entitlements that exceed actual entitlements under the NFA.

There the choice confronting this Court was between regulation of the cooperative's wholesale rates by the APSC or no regulation in view of the Federal Power Commission's (now the FERC) earlier determination that it lacked jurisdiction over such rates under the Act. The Court's affirmance of the APSC's assertion of jurisdiction by the APSC over otherwise unregulated rates, notwithstanding that the cooperative was tied to the interstate grid, on the basis of a balancing test is plainly different. There was not a hint of discriminatory, economic protection at work in that case.

Furthermore, the bare facts that "the setting of retail electric rates for Nantahala's customers is clearly a legitimate North Carolina interest with a significant impact in this state", and that the price charged to Nantahala's retail customers may have only a *"de minimis"* effect on the "interstate 'grid' " (313 N.C. at 717), do not entitle North Carolina to a more lenient balancing test applied in that case for facially neutral economic regulation. In *NEPCO,* this Court could have applied a similar rationale to uphold the New Hampshire Commission's order since New Hampshire clearly has an interest in keeping electric rates within its borders as low as lawfully possible. Thus, the lower court's effort to distinguish *NEPCO* fails and the decision should not stand.

CONCLUSION

The Court should note probable jurisdiction.

Respectfully submitted,

ROBERT L. BAUM
Counsel of Record
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-7400

RICHARD M. MERRIMAN
ROBERT S. WATERS
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-0100

Attorneys for Edison Electric Institute

Of Counsel:

REID & PRIEST

October 1985

(4)

No. 85-568

In the Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY, ET AL.,
PETITIONERS

v.

STATE OF NORTH CAROLINA, ET AL.

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOANNE LEVEQUE
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

1888

QUESTIONS PRESENTED

Under the Federal Power Act, the Federal Energy Regulatory Commission has sole authority over transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce. The questions presented are:

1. Whether the North Carolina Utilities Commission acted in contravention of the Supremacy Clause in failing to give effect in calculating the retail rates for local end-users in North Carolina to the costs and allocations contained in the federally regulated interstate wholesale transactions that preceded the final retail sale.

2. Whether the North Carolina Utilities Commission rate order at issue in this case is also invalid under the Commerce Clause because of the economic preferences it grants local consumers at the expense of interstate markets.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-568

NANTAHALA POWER AND LIGHT COMPANY, ET AL., PETITIONERS

v.

STATE OF NORTH CAROLINA, ET AL.

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

INTEREST OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Article I, Section 8, Clause 3 of the United States Constitution provides that "[t]he Congress shall have Power * * * [t]o regulate Commerce * * * among the several States"; pursuant to that authority, Congress has charged the Federal Energy Regulatory Commission with the responsibility for administering the Federal Power Act, 16 U.S.C. 791a *et seq.*, including those provisions governing rates and charges for electric energy at wholesale in interstate commerce. 16 U.S.C. 824d, 824e. The North Carolina decision challenged in this case significantly intrudes upon the Commission's area of statutory responsibility by adopting a retail rate structure that departs substantially from the terms recognized by the Commission for wholesale transactions. Subordinating the federal determinations to those of the State undermines the uniform regulatory system contemplated by Congress.

STATEMENT

A. *Background: The Relevant Agreements.* Nantahala Power and Light Company, an electric utility serving the public in North Carolina, is owned by Aluminum Company of America (Alcoa). Alcoa also owns Tapoco Inc., which serves exclusively Alcoa's aluminum operations in eastern Tennessee. Both companies own hydroelectric facilities along the Little Tennessee River, built many years ago with Alcoa financing and licensed by the Commission under Part I of the Federal Power Act.[1]

In the midst of these facilities is the large Fontana hydroelectric plant, built by the Tennessee Valley Authority (TVA) in the early 1940s. From the construction of Fontana until after the events relevant to this case, with very minor exceptions TVA directed the operation of all these facilities.[2] During the relevant time period, these arrangements for TVA control were governed by the New Fontana Agreement (NFA), signed in 1962, among TVA and Nantahala-Tapoco-Alcoa. That agreement provided that TVA would direct Nantahala's and Tapoco's operations of their hydroelectric plants and take all the energy generated from them, which would vary according to stream flow conditions. In return, certain specific entitlements to energy and power were to be supplied to Nantahala and Tapoco-Alcoa by TVA. The NFA itself, however, did not detail how much of these entitlements would go to each; these matters were spelled out in separate agreements. For puposes of this case, the relevant document is the 1971 Apportionment Agreement between Nantahala and Tapoco.

Both Nantahala and Alcoa bought power from TVA to meet their needs beyond what they received as entitlements

[1] See 16 U.S.C. 797(e).

[2] This permitted TVA to coordinate them for the most efficient total operation.

from TVA under the NFA, as provided for in the 1971 Apportionment Agreement.[3] However, this power purchased from TVA was relatively expensive—it cost about three times as much as entitlement power. Thus, the entitlement power received under the NFA, with costs based on the cost of running the Nantahala and Tapoco generating units, was less than 6 miles per kilowatt hour (kwh); the cost of power purchased from TVA with its higher expenses averaged about 19½ mils per kwh.[4]

B. *The Decision Of The Commission.* In 1982, the Commission issued two orders in *Nantahala Power & Light Co.*, 19 F.E.R.C. ¶ 61,152, aff'd in part and reh'g denied in part, 20 F.E.R.C. ¶ 61,430. See J.S. App. 283a-301a, 302a-313a. These orders arose out of a rate increase filed by Nantahala and a complaint proceeding filed by certain of its customers. Following appeals by Nantahala, by some of its customers and by the Attorney General of North Carolina, the court of appeals affirmed the Commission's decision in all respects. *Nantahala Power & Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984).

In the proceedings before it, the Commission had examined the NFA and the 1971 Apportionment Agreement, which were filed with it as rate schedules. The Commission held that the NFA was "the result of arms' length bargaining" and that it "indicates no intent on the part of any of the parties to ignore the needs of Nantahala's public service customers or deprive them of energy at just and reasonable rates." 19 F.E.R.C. at 61,278. The Commission did decide, however, that adjustments were required in the 1971 Apportionment Agreement to give a somewhat

[3] Alcoa, unlike Nantahala's customers, made its own power purchasing arrangements directly with TVA.

[4] Nantahala's and Tapoco's generation is all old, low cost hydropower; TVA, as hydro sources were exhausted, has more recently had to add considerable capacity from more costly, non-hydro sources, and to distribute these costs to its customers.

bigger share of the entitlements from TVA to Nantahala, and decided how much that greater share would be. *Id.* at 61,279-61,280.

Based on that readjustment, the Commission established the rates that Nantahala could collect from its three wholesale customers in North Carolina: Once the Commission established the division of entitlements, it followed that the remaining volumes of power required would be purchased from TVA under the contractually established rates. Rates to Nantahala's wholesale customers thus reflect the respective costs of its entitlements and its purchased power.

C. *The Ruling Of The North Carolina Commission And The State Supreme Court.* The North Carolina Utilities Commission (NCUC), in its review of retail rates, in effect rejected the NFA on the basis that it was unfair to Nantahala and did not result in just and reasonable rates (J.S. App. 15a, 32a, 70a-71a).[5] It substituted an approach proposed by Nantahala's customers,[6] which would give Nantahala, and consequently the North Carolina customers, a larger share of the low cost entitlements, and correspondingly reduce their need for expensive purchases.

Specifically, the NCUC first calculated the available capacity and energy, which it defined to include the capacity of and energy available from both the Nantahala *and* Tapoco facilities (J.S. App. 68a-69a). This reflected the figures available to TVA, rather than the smaller volumes of entitlements which Nantahala and Tapoco received from TVA for delivery to their customers.

[5] The NCUC decisions are unreported and appear at J.S. App. 165a-235a, 236a-247a. The opinion of the North Carolina Court of Appeals (J.S. App. 141a-164a) is reported at 65 N.C. App. 198, 309 S.E.2d 473 (1983), and the opinion of the North Carolina Supreme Court (J.S. App. 1a-138a) is reported at 313 N.C. 614, 332 S.E.2d 397 (1985).

[6] The FERC had earlier rejected that approach. See *Nantahala*, 727 F.2d at 1347-1349.

The NCUC then added to this calculation the amount of power and energy Nantahala bought from TVA and delivered to its customers; it did not include Alcoa's TVA purchases (J.S. App. 68a-69a). This amount defined the NCUC's "pool" of power. The NCUC next calculated how much power Nantahala needed to serve its customers. At that time, it amounted to about 25% of the pool (J.S. App. 68a-69a). The NCUC then totalled the costs associated with generating power from both the Nantahala and Tapoco facilities and the cost of Nantahala's purchased power (but not Alcoa's). It applied the 25% figure to that amount to derive what Nantahala would be allowed to collect from its North Carolina retail ratepayers.

This method of calculation resulted in a shift of low cost power to the Nantahala load compared with what the Commission had determined in its proceeding. As the NCUC said, it gave Nantahala "first call" on the electric energy output deemed available (J.S. App. 183a). Unlike Nantahala's customers, Alcoa (Tapoco's customer) would not get an allocation based on its needs. It was left only with whatever residual low cost power remained after both Nantahala and TVA had taken their supplies of "available" power. At the same time, Alcoa was made responsible for all the residual costs after what the NCUC assigned Nantahala (J.S. App. 69a-70a). Alcoa thus was required to assume the costs not only of all of its own TVA purchases, but 75% of Nantahala's as well. Alcoa's share of the costs was further swollen by that attributable to the power that went to TVA and was not reflected in entitlements received in return.

The North Carolina Supreme Court recognized that there were substantial questions under the United States Constitution concerning preemption and interference with interstate commerce (J.S. App. 12a-13a). It concluded, however, that there was no constitutional infirmity and affirmed the NCUC in all relevant aspects (J.S. App. 12a, 72a-106a).

DISCUSSION

This case presents an important question concerning the scope of permissible state authority within the federal regulatory scheme established by the Federal Power Act. The Federal Energy Regulating Commission has made determinations pursuant to its unquestioned authority over wholesale transactions concerning how "entitlements" to certain power, received in return for other power, should be divided between two utilities, serving neighboring states. Those determinations have been reviewed and affirmed by the United States Court of Appeals for the Fourth Circuit. Despite this exercise of federal authority, North Carolina, on the ground that it was carrying out its retail ratemaking responsibilities, declined to give effect to—and indeed adopted a rate structure sharply at odds with—the supply arrangements adopted by the Commission.

The result is that the state authority substituted its judgment for that of the Commission and gave its own citizens a bigger share of the low cost power, leaving less for the neighboring state's customer. In so doing, the North Carolina Utilities Commission has seriously undermined the Commission's jurisdiction under the Federal Power Act, and has done violence to fundamental Commerce Clause principles. The NCUC is intruding on the Commission's area of responsibility, acting in disregard of Commerce Clause principles and strong precedent established by decisions of this Court. In these circumstances, plenary review is warranted.

A.

1. Electric power moves freely across state lines, via a vast interstate transmission grid, and, as a result, "production and transmission of electricity is an activity particularly likely to affect more than one State." *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service*

Commission, 461 U.S. 375, 377 (1983). Accordingly, "maintaining the proper balance between state and federal authority * * * has long been a serious challenge to both judicial and congressional wisdom." *Ibid.* Under the Federal Power Act, the Commission is given complete authority over wholesale activity (bulk power arrangements between utilities) while the states regulate retail activity (with the ultimate consumer). 16 U.S.C. 824. This jurisdictional line, however, is not as bright as might appear on first impression, since by their nature, wholesale rates at some subsequent point are embedded in retail costs.

Disputes over the scope of federal versus state regulation have been arising with increasing frequency as interutility arrangements grow in number. A considerable body of case law has developed at the state court level, holding that states are prohibited from re-evaluating the wholesale rates and disallowing those deemed unreasonable as costs for retail ratemaking purposes.[7] The NCUC decision in this case is fundamentally inconsistent with that case law.[8]

---

[7] See, *e.g.*, *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), cert., denied, 435 U.S. 972 (1978); *Northern States Power Co.* v. *Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn. 1984), cert. denied, No. 83-1752 (June 18, 1984); *Eastern Edison Co.* v. *Department of Public Utilities*, 388 Mass. 292, 446 N.E.2d 684 (1983); *Washington Gas Light Co.* v. *Public Service Commission*, 452 A.2d 375 (D.C. 1982), cert. denied, 462 U.S. 1107 (1983); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981); *United Gas Corp.* v. *Mississippi Public Service Commission*, 240 Miss. 405, 127 So. 2d 404 (1961); *City of Chicago* v. *Illinois Commerce Commission*, 13 Ill. 2d 607, 150 N.E.2d 776 (1958).

[8] While the principle now seems well-established in the case law, nonetheless these cases are still continuing to arise today. Appellants have cited in of their juridictional statement (at 20 n.29), for example, a number of very recent decisions involving the Middle South Utilities and American Electric Power complexes of companies.

2. This court has yet to address the matter directly. However, it has long been established that under the Federal Power Act, the federal government has preempted the entire wholesale area. See, *e.g.*, *New England Power Co.* v. *New Hampshire*, 455 U.S. 331, 340 (1982); *Maryland* v. *Louisiana*, 451 U.S. 725, 750-751 (1981); *Arkansas Electric Cooperative*, 461 U.S. at 381.[9] Not only does the federal scheme leave no room for direct state regulation of wholesale prices, it leaves no room either for state regulations that indirectly yield the same result. *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84, 91 (1963).

It is also well established that a rate filed with the Commission and subject to its jurisdiction cannot be challenged in another forum; only the Commission is empowered to order it changed. *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-252 (1951) ("We hold that the right to a reasonable rate is the right to the rate which the Commission files or fixes, and that, except for review of the Commission's orders, the court[] can assume no right to a different one on the ground that, in its opinion, it is the only or the more reasonable one."). Under governing preemption doctrine, the filed rate is reasonable as a matter of law and any effort by a state to disregard or reject it is impermissible. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 581-582 (1981). While the North Carolina Supreme Court pays lip service to this settled rule, it has effectively asserted the authority to disregard the Commission's filed rate. The state court recognizes that the Commission has exclusive jurisdiction over the wholesale power transactions and agreements between and among Nantahala,

[9] The Supremacy Clause establishes that "[t]his Constitution, and the laws of the United States which shall be made in Pursuance thereof * * * shall be the supreme Law of the Land * * * any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. Art. VI, Cl. 2.

Tapoco, Alcoa and TVA (J.S. App. 12a), but nonetheless proceeds substantially to revamp that structure more to its own liking. This the Supremacy Clause prohibits. *Arkansas Electric Cooperative*, 461 U.S. at 389; *Fidelity Federal Saving & Loan Association* v. *de la Cuesta*, 458 U.S. 141, 153 (1982).

3. At the core of this case rests a classic dispute concerning the allocation of the inexpensive entitlement power, and the costs associated with it, between customers in different states. A state of course has a legitimate interest in reducing the cost to its citizens of electric power, but its authority to effectuate that reduction is not unbounded; there are constitutional limitations inherent in our federal structure that must be obeyed. In this case, there is a finite amount of the cheap power, and a pool of costs that must be absorbed by someone. The approach employed by the NCUC would benefit the Nantahala customers by giving them more of the low cost entitlement power, and permitting them to absorb less of the costs associated with that power. However, it would have the concomitant result of forcing additional costs on the other customer, the one located in Tennessee.

Under the Federal Power Act, Congress has established a federal regulatory authority to deal with what have long been properly viewed as matters of inherently interstate concern, the bulk power arrangements between utilities so important in the electric utility business today. The Commission is empowered to make or review these arrangements. It is inconsistent with the scheme Congress has established to permit state authorities to change these arrangements to make them more favorable to their own citizens at the expense of operations in other states.[10]

[10] It is clear that is what the State has done here. At an earlier stage of this case, the North Carolina Supreme Court remanded the case to the NCUC to determine whether the approach Nantahala's customers were proposing "would be in the best interests of the customers of Nantahala." *State ex rel. Utilities Commission* v. *Edmisten*, 299 N.C. 432, 434, 263 S.E.2d 583, 586 (1980).

The system Congress established explicitly provides states and state commissions with a significant role within the federal regulatory framework. The states may file complaints about inter-utility activities (16 U.S.C. 825e), and these complaints may ultimately result in Commission action declaring rates, practices and contracts unjust and unreasonable and establishing new ones (16 U.S.C. 824e(a), 824d(e)). The states may also seek review of Commission orders in the federal courts (16 U.S.C. 825*l*(b)). What the states are precluded from doing, however, is acting inconsistently with Commission determinations with which they are dissatisfied. By effectively invalidating federally filed arrangements, the state is indirectly dictating the wholesale price, in derogation of the Commission's responsibility. To permit that dictation is flatly inconsistent with the federal regulatory framework established by Congress.

B.

1. Even if, contrary to our submission, the Federal Power Act leaves room for some state regulation affecting commission regulated transactions, the state may not, as a constitutional matter, enforce "protectionist regulation that the Commerce Clause declares off-limits to the states." *New England Power Co.*, 455 U.S. at 339. See also *City of Philadelphia* v. *New Jersey*, 437 U.S. 617, 623-624 (1978).[11] "Economic protectionism" may be found on the basis of either discriminatory purpose or discriminatory effect. *Bacchus Imports, Ltd.* v. *Dias*, No. 82-1565 (June 29, 1984), slip op. 6; *City of Philadelphia* v. *New Jersey*, 437 U.S. at 626. The cost shifting reflected in the NCUC's

[11] "[T]he [Commerce] Clause has long been recognized as a self-executing limitation on the power of the States to enact laws imposing substantial burdens on [interstate] commerce." *South-Central Timber Development Inc.* v. *Wunnicke*, No. 82-1608 (May 22, 1984), slip op. 5.

"first call" approach, designed to further the "best interests" of North Carolina customers (note 10, *supra*), is suspect on both grounds (see pages 4-5, *supra*).

2. There is an alternative standard for determining the extent of permissible state action in the absence of any federal action: even-handed regulation with only incidental effects on interstate commerce. See *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); *City of Philadelphia* v. *New Jersey*, 437 U.S. at 624; *Hughes* v. *Oklahoma*, 441 U.S. 322, 331 (1979); *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 36 (1980). Formidable difficulties in the interstate utility context, however, may make this a less than fully satisfactory standard for the Court to apply in this case.

On the one hand, when it comes to distributing something between two states, any decision by one state to benefit its people necessarily will place an offsetting burden on interstate commerce; the relationship is such that this burden is properly characterized as direct, rather than merely incidental. On the other hand, as the First Circuit observed in *Massachusetts* v. *United States*, 729 F.2d 886, 888 (1984):

> [when allocating costs of power between customers in two states] [n]either law nor economics can identify one unique set of rates or practices as "reasonable," *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251 71 S.Ct. 692, 695, 95 L.Ed. 912 (1951), and each state would prefer a rate structure that benefitted its residents to the detriment of its neighbors.

The net result of permitting each state to enact its own reasonable regulation may nevertheless be an unacceptable overall system.[12]

[12] For example, where the ratemaking question at issue is whether or not to consolidate the operational costs of companies serving different states, sometimes a reasonable argument can be made for or

For this reason, neither the Commerce Clause nor the prohibition against confiscation in the Fourteenth Amendment[13] provide fully satisfactory guidelines for resolving conflicting state interests. This is, at least in part, because ratemaking is inherently a legislative function. *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 589 (1945). See also *FPC* v. *Texaco Inc.*, 417 U.S. 380, 389 (1974). The Commission, which has independent statutory power to set rates, is better equipped than the Court to undertake this function.

3. There is a well established distinction in the electric power area between what is "essentially local" and what is "essentially national" and thus beyond the reach of state authority. *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83, 90 (1927); *Arkansas Electric Cooperative Corp.*, 461 U.S. at 390. This case involves a matter that falls squarely into the "essentially national" category, involving competing state interests that inherently call for the exercise of impartial federal authority.[14] The effect of the NCUC's decision to ignore the Commission's allocation for the purpose of setting retail rates, reflects

against such a consolidation. Rates are tied to costs, and so a state with companies that have above average costs would probably opt for consolidation, while its neighbor, with companies that have below average costs, would not. While each individual state decision to favor its own consumers in establishing rates would be reasonable, the net result would be that the revenue to plants operating in the two-state area would be inadequate to cover their costs.

[13] See, *e.g.*, *Missouri ex rel Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U.S. 276, 289 (1923); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

[14] Cf. *South-Central Timber Development, Inc.* v. *Wunnicke*, slip op. 9-10. The need to resolve such competing state interests is the fundamental justification for the Commerce Clause. See *Hughes* v. *Oklahoma*, 441 U.S. 322, 325, 326 (1979); *Bacchus Imports, Ltd.* v. *Dias*, slip op. 7-10; *H.P. Hood & Sons, Inc.* v. *Du Mond*, 336 U.S. 525, 533-534 (1949).

the same sort of direct burden on interstate commerce that the Eighth Circuit recently found unconstitutional on Commerce Clause grounds in *Middle South Energy, Inc.* v. *Arkansas Public Service Commission*, No. 84-2409 (8th Cir. Aug. 23, 1985), slip op. 22-23.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

CHARLES FRIED
Solicitor General

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOANNE LEVEQUE
Attorney
Federal Energy Regulatory Commission

OCTOBER 1985

No. 85-568

In The

Supreme Court of the United States

October Term, 1985

Nantahala Power and Light Company; Tapoco, Inc.; and Aluminum Company Of America,
Appellants,

vs.

State Of North Carolina ex rel. Utilities Commission; Lacy H. Thornburg, Attorney General; et al.,
Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF THE STATE OF TENNESSEE AS AMICUS CURIAE IN SUPPORT OF THE JURISDICTIONAL STATEMENT

W. J. Michael Cody
Attorney General of Tennessee

Jim G. Creecy
Counsel of Record
Associate Chief Deputy Attorney General

Charles L. Lewis
Deputy Attorney General
450 James Robertson Parkway
Nashville, Tennessee 37219
(615) 741-2968

Attorneys for the State of Tennessee

St. Louis Law Printing Co., Inc., 411 No. Tenth Street 63101 314-231-4477

QUESTIONS PRESENTED

1. Whether under the Commerce Clause a state, in setting retail electric rates within its borders, may give its citizens a preference to the inexpensive hydroelectric power generated and consumed in a multistate area?

2. Whether one state, in regulating retail electric rates within its borders, may set aside the interstate allocations of wholesale power and costs established by the Federal Energy Regulatory Commission, and impose a different allocation of costs which is more favorable to its own citizens?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER and LIGHT COMPANY; TAPOCO, INC.; and ALUMINUM COMPANY OF AMERICA,
Appellants,

VS.

STATE OF NORTH CAROLINA ex rel. UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL; et al.,
Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF THE STATE OF TENNESSEE AS AMICUS CURIAE IN SUPPORT OF THE JURISDICTIONAL STATEMENT

In accordance with this Court's Rule 36, the State of Tennessee, through its Attorney General, W.J. Michael Cody, and on behalf of its Department of Economic and Community Development, submits this brief as amicus curiae in support of the Jurisdictional Statement filed by Nantahala Power and Light Company; Tapoco, Inc.; and the Aluminum Company of America. Authority for the filing of the brief is found explicitly at Supreme Court Rules 36.1 and 36.4.

INTEREST OF THE STATE OF TENNESSEE

This case concerns the basic design of our federal system of government and the relationship of the states to each other and to federal authority. It involves the rights of the State of Tennessee and of its citizens within that framework. Tennessee has a vital interest in this case, both for jurisdictional reasons and because of its immediate impact on the economy of the State and the livelihoods of its citizens. The decision of the court below, if left undisturbed by this High Court, will have serious economic consequences in Tennessee. If the Alcoa facility in Tennessee is deprived of the inexpensive power that North Carolina has appropriated for itself, then the Tennessee facility may well be so uneconomical, in the power-intensive aluminum industry, as to require its closure. This would produce severe economic dislocations in Blount and surrounding counties in East Tennessee. It would cause the immediate loss of approximately four thousand jobs at the Alcoa facility alone, as well as additional thousands of related jobs in the area.

The decision of the North Carolina Utilities Commission, as upheld by the North Carolina Supreme Court, would divert from Tennessee to North Carolina the economic benefits of inexpensive hydroelectric power previously allotted to Tennessee by the Federal Energy Regulatory Commission (FERC). That this has been accomplished through the device of a local ratemaking proceeding in North Carolina makes its impact no less grievous. The reality of the situation is that North Carolina has overruled the decision of the FERC, which regulates the interstate flow of the power resources and associated costs in the region.[1] The North Carolina Commission has done this without

[1] The only exception to FERC regulation relates to the Tennessee Valley Authority (TVA), a major supplier of electric power in the region. As a federal government corporation, TVA, under the terms of its enabling statute, establishes its own rates. *See* 16 U.S.C. § 831 k.

considering the needs of Tennessee or its rights under FERC-approved rate schedules, determining instead that North Carolina customers are entitled to a "first call" preference on the inexpensive power resources of the mountain region.

Consequently, Tennessee is intensely interested in the outcome of this litigation, believing as it does that adherence to FERC's objective allocation of power and costs will prevent the economic devastation of mid-East Tennessee. Tennessee believes that review of this important case by this Court would establish the principle that one state cannot ignore and wholly supersede the allocation of power and costs among separate states determined by the FERC. Thus the outcome of this case will have a profound impact in Tennessee.

STATEMENT

Tennessee shares with North Carolina and other states the power resources of the southern Appalachian region, including a number of hydroelectric generation sites. A portion of the inexpensive hydroelectric power generated in North Carolina and Tennessee historically has been supplied by Tapoco, a Tennessee company, to one of Tennessee's large industrial power consumers, the Aluminum Company of America plant at Alcoa, Tennessee. Tapoco's use of this hydroelectric power to serve the Alcoa facility has been approved by the Federal Energy Regulatory Commission (FERC), the federal agency having exclusive jurisdiction over wholesale electric rates and the allocation of wholesale power among states.

In the instant case, however, the State of North Carolina, through its Utilities Commission, has for all practical purposes overruled the FERC and adopted a new method of distributing power costs in the southern mountain region. It has used as a convenient vehicle the fact that Nantahala Power and Light Company, the utility serving consumers in western Carolina,

and Tapoco, Inc., the utility serving the Alcoa plant in Tennessee, are both subsidiaries of Alcoa. While North Carolina's actions take the form of establishing retail rates in that state, the peculiar roll-in device used by the Utilities Commission produces a complete usurpation of FERC regulation. Moreover, when combined with the unjustified presumption that all the inexpensive power should first go to serve the North Carolina public load, the result effectively deprives Tennessee of the protection of FERC's impartial ratemakers.

The result is that Tennessee and one of its most important industrial facilities will be deprived of the benefits of the portion of the inexpensive hydropower allocated to them by FERC. This has been accomplished wholly through ratemaking proceedings in the agencies and tribunals of North Carolina, which are charged under North Carolina law with promoting the interests of North Carolina citizens. Whatever the institutional leanings of the North Carolina regulatory process, Tennessee has had no opportunity to participate in the decisions at issue. The North Carolina tribunals have acted without regard for FERC's findings, which were derived from proceedings that took into account all the interested parties and to which the North Carolina Attorney General and Nantahala's customers were parties. The FERC determinations were upheld by the United States Court of appeals for the Fourth Circuit. *Nantahala Power and Light Co. v. FERC*, 727 F.2d 1342 (4th Cir. 1984). Now the North Carolina authorities have superseded the federal findings and set Nantahala's rates in a manner that directly contradicts them, not only giving Nantahala's customers priority with respect to all the inexpensive hydropower in the region, but imposing a direct financial burden on a customer located in Tennessee. As a result the economy of East Tennessee is threatened with severe dislocations.

REASONS WHY THIS COURT SHOULD NOTE PROBABLE JURISDICTION

I.

The Decision Below Is Of National Importance And Merits Review By The Court.

The decision of the North Carolina tribunals is an affront to Tennessee's sovereignty and the comity that ought to exist between neighboring states. The regulation of interstate commerce in instances such as this was a paramount reason for the creation of the Federal Union and the Constitution. This Court ought to review such a blatant attempt by a state to gather unto itself scarce economic resources at the expense of its sister states.

This case is of great, immediate importance to the economy of the State of Tennessee. It is of even greater precedential importance to the electric power industry and to regulatory commissions in many states. Review by this Court will have repercussions in many state utility commissions that are being tempted to ignore FERC cost allocations and give their constituents preference in distributing scarce economic resources. Action by this Court is necessary to protect the effectiveness of the Federal Power Act and preserve the unified, national market in such resources envisioned by the framers of the Commerce Clause. These issues are of sufficient magnitude and nationwide concern to merit this High Court's review.

The transmission and sale of electric power in interstate commerce has long been of concern to the federal government. For this reason the Federal Power Act was framed to ensure that wholesale power transmission and sales would be fostered and not impeded by state regulation. The decision below by the Supreme Court of North Carolina is antithetical to these concerns and contravenes the letter and intent of both the Federal Power Act and the Commerce Clause.

The North Carolina Court has held that a state may examine interstate power allocations and set retail rates wholly without regard for the allocation of wholesale costs made by the FERC. It has rendered the FERC determination in the instant case meaningless. Should each state adopt a similar approach and give its own residents preference in electrical entitlements, the entire system of interstate wholesale power transmission would disintegrate into chaos and petty rivalries. The notion that a state utility commission may ignore FERC-approved wholesale costs in setting local retail power rates warrants prompt review by this Court.

II.

The North Carolina Decision Interferes With Commerce Between The States In Electricity.

The decision of the North Carolina tribunals is a parochial one. It seeks to restrict to that state the benefits of low-cost power generated in the mountains along with the North Carolina-Tennessee border. It denigrates any claim to a part of the hydropower that might be asserted by Tennessee or other states. In so doing, the decision comes into direct conflict with the Commerce Clause of the Constitution, which gives all Americans access to our scarce resources and prevents any state from sealing itself off from the national economy.

The North Carolina decision expressly is designed to further the best interests of the customers of Nantahala, all of whom are North Carolinians. It gives those customers first call on all the electric energy output of the combined systems of Nantahala and Tapoco. *See North Carolina ex rel. Utilities Commission v. Edmisten,* 299 N.C. 432, 434, 263 S.E.2d 583, 586 (1980); Appendix to Jurisdictional Statement at 183a. It ignores the countervailing interests and needs of Tennessee. It represents precisely the sort of burden on commerce that the Constitution

prohibits. *See Public Utilities Commission v. Attleboro Steam & Electric Co.,* 273 U.S. 83 (1927); *Edgar v. MITE Corp.,* 457 U.S. 624 (1982).

The decision below does not physically prevent the flow of electric current, but its economic effect is exactly the same. It amounts to a burden on the transfer of power from North Carolina to Tennessee, since it reassigns the benefits of low-cost hydropower from Tapoco's customer in Tennessee to Nantahala's customers in North Carolina. The decision thus directly conflicts with *New England Power Co. v. New Hampshire,* 455 U.S. 331 (1982). In that case New Hampshire did not prevent the flow of power across its border, but it set retail rates as if hydropower exported to other states had been consumed in New Hampshire. This Court struck down New Hampshire's efforts, holding its actions to constitute a burden on commerce. The instant case fits into the same category.

A similar approach has recently been adopted by the Eighth Circuit in *Middle South Energy, Inc. v. Arkansas Public Service* Commission, ____ F.2d ____ (8th Cir. August 23, 1985). In that matter the FERC had allocated power and associated costs among related utilities in four states. Those included the high cost of a nuclear power plant. Arkansas tried to reject those costs in setting retail rates, so its consumers would bear none of the nuclear plant costs. The Eighth Circuit held that Arkansas had contravened the Commerce Clause since it gave its citizens a preference over those of other states.

Here the North Carolina Commission has given the customers in that state preference with respect to all the cheap power, both that generated in North Carolina and that generated in Tennessee. Under its reasoning, as Nantahala's load grows, Tennessee in a few years will receive none of the hydroelectric power. North Carolina has thus instituted a blatantly protectionist policy that significantly impedes the flow of electric power in interstate commerce. By so doing it has infringed the

Commerce Clause. This Court should review the decision below to vindicate the interests of the national economy and in particular the rights of Tennessee to an unimpeded power supply.

III.

The Federal Power Act Mandates That North Carolina Accept Wholesale Costs Established By FERC In Setting Its Retail Rates.

The Federal Power Act contemplates that the FERC will regulate the sale and transmission of electricity among the several states and establish wholesale power costs. The states are then to include these costs in determining retail rates for the domestic utilities which they regulate. Under the "filed rate" doctrine, state commissioners must treat the rates fixed by the FERC as reasonable operating expenses for all purposes. *See Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951). This does not prevent a state commission from finding that increases in FERC-approved rates are offset by savings in other facets of the utility's operations. It does mean, however, that the rates set by FERC are the foundation of any such calculations of retail rates. Nevertheless, the decision below has rejected the FERC's determinations about Nantahala's power costs and has reconsidered all aspects of its operations, reaching conclusions diametrically opposed to those of FERC when it considered the same matters. Such flouting of the rate schedules established by FERC cannot be tolerated under the Federal Power Act.

Under the approach adopted by the North Carolina Supreme Court, the Utilities Commission in that state may wholly disregard FERC's determinations and decide for itself that electricity arrangements between states are unreasonable. It may then refuse to permit local utilities to recover the costs they incur under FERC's wholesale rate schedules. While the decision

below does not propose to overturn the FERC's decision, its result is exactly that. The costs that consequently are not then covered by the North Carolina rates are shifted to consumers in other states.

The absurdity of the North Carolina view is best illustrated by supposing the Tennessee Public Service Commission might take the same approach and decide Tapoco's rates are too high and that Tennessee should have first call on all the inexpensive hydropower.[2] This would leave both Tapoco and Nantahala (as well as their parent Alcoa) in limbo, since neither could recover its cost of service, and both might be unable to serve their customers.

The role of FERC in power regulation at the wholesale level is inconsequential if its determinations do not carry through to influence retail rates. For this reason many courts have held that state commissions must provide for FERC-approved wholesale charges in establishing retail rates. *See Washington Gas Light Co. v. Public Service Commission*, 452 A.2d 375 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983); *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978). This obviously means that the states may not reexamine FERC's wholesale cost allocations, but must accept them at face value and incorporate them in their decision-making. *See Northern States Power Co. v. Minnesota Public Service Commission*, 344 N.W.2d 374 (Minn.), *cert. denied*, ___ U.S. ___, 104 S.Ct. 3546 (1984); *Northern States Power Co. v. Hagen*, 314 N.W.2d 32 (N.D. 1981); *Office of Public Counsellor v. Indiana & Michigan Electric Co.*, 416 N.E.2d 161 (Ind.App. 1981).

---

[2] The history of the development of hydropower in the Southern mountains and the allocation thereof might well be viewed as giving Tapoco a far better claim to the cheap power than Nantahala or any North Carolina interests.

The approach used by the North Carolina Commission was to "roll-in" the power supplies and costs of Nantahala and Tapoco as if they were one system, and then to allocate to Nantahala the lion's share of low-cost power, leaving only a minimal amount for Tapoco. Under this approach, Tapoco in the near future will be allotted no hydroelectric power. This is directly contrary to FERC's determination that the agreements between the parties are fair to all concerned. This unilateral action of North Carolina has left Tennessee without any voice in the decision-making process and has nullified the authority of FERC in North Carolina. This Court ought to review the matter and hold that the Federal Power Act has preempted North Carolina from making such determinations.

CONCLUSION

The State of Tennessee submits that the Court should note probable jurisdiction and set the case for argument on its merits. Otherwise the Commerce Clause and the Federal Power Act will have been overridden by the parochial actions of one state. Tennessee believes that its right to participate in the decision-making process and its citizens' entitlement to a fair share of the region's hydroelectric power deserve the protection of this High Court.

Respectfully submitted,

W.J. MICHAEL CODY
Attorney General of Tennessee

JIM G. CREECY
Associate Chief Deputy
Attorney General
Counsel of Record

CHARLES L. LEWIS
Deputy Attorney General
450 James Robertson Parkway
Nashville, Tennessee 37219
(615) 741-2968

Counsel for the State of Tennessee, as Amicus Curiae

(6)

No. 85-568

IN THE
Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,
Appellants,
v.
STATE OF NORTH CAROLINA ex rel. UTILITIES COMMISSION; LACY H. THORNBURG, Attorney General, et al.,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* AND BRIEF OF UNITED STEELWORKERS OF AMERICA, AFL-CIO AND ITS LOCAL UNION 309 AS *AMICUS CURIAE* IN SUPPORT OF THE JURISDICTIONAL STATEMENT

CARL B. FRANKEL
Counsel of Record
United Steelworkers of America, AFL-CIO
Five Gateway Center
Pittsburgh, PA 15222
(412) 562-2541

HERRICK & HELD PRINTING COMPANY, PITTSBURGH, PA. 15233-2182 17

14 P

No. 85-568

In The
Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,
Appellants,

v.

STATE OF NORTH CAROLINA ex rel. UTILITIES COMMISSION; LACY H. THORNBURG, Attorney General, et al.,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

Now comes United Steelworkers of America, AFL-CIO and its Local Union 309 (jointly referred to as "the Union") and respectfully submit this Motion for Leave to File Brief as *Amicus Curiae* in Support of the Jurisdictional Statement, pursuant to Rules 36 and 42 of the Rules of the United States Supreme Court. The brief is conditionally attached to this motion and lodged herewith. In support thereof, the Union states as follows:

1. The above-captioned matter is before the Court pursuant to Appellants' appeal from a judgment entered on July 3, 1985 by the North Carolina Supreme Court upholding certain orders of the North Carolina Utilities Commission ("NCUC") which required, *inter alia,* Appellant Aluminum

Company of America (herein "Alcoa") to pay a refund of approximately $29 million to the North Carolina customers of its subsidiary, Nantahala Power & Light Company (herein "Nantahala").

2. Succinctly, Alcoa alleges that the NCUC orders should not have been upheld because, *inter alia*, the NCUC improperly regulated matters subject to the exclusive jurisdiction of the Federal Energy Regulatory Commission and impermissibly burdened interstate commerce in the generation, transmission, and sale of electricity. Alcoa asserts that the effect of these orders may be to force curtailment of production of its smelting and fabricating facilities in Alcoa, Tennessee (herein "Tennessee facilities") resulting in diminished employment opportunities for the Union's members.

3. The Union is the collective bargaining agent for some 3,500 Alcoa employees working in the Tennessee facilities, and represents those employees with regard to their wages, hours, and other working conditions and terms of employment. The interest of the Union in this matter is the job security of all individual Union members who are employed by Alcoa and are represented by the Union and whose continued full-time employment at the Tennessee facilities the Union seeks to protect. Curtailment of Alcoa's operations at these facilities may directly and adversely impact upon the lives and well-being of the Union's members.

4. The interests of the Union are not in all respects those of Alcoa. While the Union's interests in preserving full employment at the Tennessee facilities is shared by Alcoa to a degree, should the judgment of the North Carolina Supreme Court be

upheld and, as a result, energy costs, a significant component in the cost of producing aluminum, escalate, Alcoa may reasonably be expected to maintain profit levels by shifting production to facilities outside of Tennessee where production costs are lower. That would cause serious harm to Union members employed at the Tennessee facilities. Thus, Alcoa's economic interests are not co-terminous with the Union's interest in preserving employment. The filing of this brief as *amicus curiae* is desirous therefore, as it places before the Court arguments on behalf of a separate, substantial employee interest advocated by no other party in this proceeding.

5. Counsel for the North Carolina Appellees has refused to consent to the Union's filing of a brief as *amicus curiae*. Other parties have consented.

CONCLUSION

For the foregoing reasons, this Motion for Leave to File Brief as *Amicus Curiae* should be granted.

Respectfully submitted,

CARL B. FRANKEL
Counsel of Record
United Steelworkers of America, AFL-CIO
Five Gateway Center
Pittsburgh, PA 15222
(412) 562-2541

QUESTION PRESENTED

Whether the State of North Carolina, acting through its Utilities Commission in the context of establishing retail electric rates under North Carolina law, unlawfully burdened interstate commerce by effectively increasing the cost of electricity to consumers in Tennessee through rate-making devices which discriminate in favor of North Carolina consumers.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

No. 85-568

In The
Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,
Appellants,
v.
STATE OF NORTH CAROLINA ex rel. UTILITIES COMMISSION; LACY H. THORNBURG, Attorney General, et al.,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

BRIEF OF UNITED STEELWORKERS OF AMERICA, AFL-CIO AND ITS LOCAL UNION 309 AS *AMICUS CURIAE* IN SUPPORT OF THE JURISDICTIONAL STATEMENT

PARTIES TO THIS PROCEEDING

The parties to this proceeding are set forth in the Jurisdictional Statement.

OPINION BELOW

The opinion below is reproduced in the Appendix to the Jurisdictional Statement and reported at 313 N.C. 614 (1985).

JURISDICTION

This Court has jurisdiction pursuant to 26 U.S.C. § 1257(2) (1982).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The constitutional provisions involved are reproduced in the Jurisdictional Statement and the statutory provisions involved are reproduced in the Appendix to the Jurisdictional Statement.

INTEREST OF THE UNION

The United Steelworkers of America, AFL-CIO and Local Union 309 ("Union") is the collective bargaining agent for some 3,500 employees working in Alcoa's aluminum manufacturing plant located in Alcoa, Tennessee ("Tennessee facilities"). The interest of the Union here is the job security of all Steelworker-represented workers employed at the Tennessee facilities and whose continued full-time employment at these facilities the Union seeks to protect.

The effect of the orders of the North Carolina Utilities Commission ("NCUC") at issue is to establish an economic preference in favor of North Carolina consumers by transferring to North Carolina the economic benefits of inexpensive hydroelectric energy historically used to operate the Tennessee facilities. As a result, the cost of energy to Alcoa will increase substantially. This, in turn, will substantially raise the cost of producing aluminum at the Tennessee facilities inasmuch as energy is a significant component of that cost. If the NCUC's orders are upheld, therefore, Alcoa may well shift production to facilities outside Tennessee to the considerable peril of 3,500 Union members at the Tennessee facilities. This brief is submitted in furtherance of

the interests of those Tennessee workers in this interstate controversy.

STATEMENT OF THE CASE

The Union adopts the Statement of the Case presented in the Jurisdictional Statement.

SUBSTANTIAL QUESTIONS ARE PRESENTED

North Carolina Cannot Lawfully Use Its Utility Rate Authority To Impose An Economic Preference In Favor Of Its Citizens Over Consumers In Another State.

In the Jurisdictional Statement, Appellants argue that the NCUC's orders interfere with the exclusive jurisdiction of the Federal Energy Regulatory Commission to regulate the manner in which electric energy is allocated and sold in interstate commerce, and that the North Carolina Supreme Court erred in failing to find the NCUC's orders in violation of the Federal Power Act, 16 U.S.C. §§ 791a *et seq.* and the Commerce Clause of the United States Constitution. U.S. Const., Art. I, § 8, cl. 3. The Union will not repeat the arguments made in the Jurisdictional Statement, but respectfully submits to the Court that the potential impact of the NCUC's actions on the Union's members in Tennessee further emphasizes the importance of having the economic issues raised in this controversy resolved by an impartial federal tribunal. Unless the Court notes probable jurisdiction, the substantial interests of Tennessee parties, including the Union, will have been adjudicated by North Carolina tribunals whose stated objective was to maximize economic benefits to the North Carolina customers of Nantahala Power and Light Company ("Nantahala").

The NCUC orders of which Appellants complain were adopted pursuant to the instructions of the North Carolina Supreme Court that the NCUC only consider what was in the "best interests" of Nantahala's North Carolina customers. *North Carolina ex. rel. Utilities Commission v. Edmisten*, 299 N.C. 432, 434, 263 S.E.2d 583, 586 (1980). Nothing in the subsequent orders of the NCUC or the North Carolina Supreme Court's decision below gives any consideration whatsoever to the detrimental effect that the NCUC's actions may have on the economy of Eastern Tennessee or the jobs of the Union's members. The fact that NCUC found that North Carolina had "first call" (App. 183a) on the economic benefits of the inexpensive hydroelectric generation of North Carolina *and* Tennessee by Alcoa's electric company subsidiaries makes it clear that Tennessee's interests were not considered.

The Court has been vigilant in enforcing the Commerce Clause to prevent the individual states from using their regulatory powers to engage in narrow economic protectionism. A very recent example, in a case which is on all fours with the facts here, is *New England Power Company v. New Hampshire*, 455 U.S. 331 (1982) ("NEPCO"). In that case, faced, as in this instance, with a state using its electric rate-making authority to appropriate for its citizens the economic advantages of hydroelectric generation in interstate commerce, the Court stated:

> Our cases consistently have held that the Commerce Clause of the Constitution, Art. I, § 8, cl. 3, precludes a state from mandating that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its

> borders or to the products derived therefrom. [citations omitted].
>
> * * *
>
> The order of the New Hampshire Commission, prohibiting New England Power from selling its hydroelectric energy outside the State of New Hampshire, is precisely the sort of protectionist regulation that the Commerce Clause declares off-limits to the states. The Commission has made it clear that its order is designed to give an economic advantage for New Hampshire citizens at the expense of New England Power's customers in neighboring states.
>
> 455 U.S. 331, 338-9

The substantiality of the questions presented in this case follows *a fortiori* from *NEPCO*.[1]

---

1. A recent decision by the Eighth Circuit underscores the point. In *Middle South Energy, Inc. v. Arkansas Public Service Commission*, 772 F.2d 404 (8th Cir. 1985), the Arkansas Public Utilities Commission sought to preclude an Arkansas utility from participating (taking power and sharing costs) in a nuclear power project designed to serve the power needs of four states. The cost and power allocations had been determined in proceedings before the FERC. The State Commission nevertheless set out to circumvent those allocations because, in its view, they portended enormous rate increases for Arkansas retail consumers and because Arkansas neither wanted nor needed the relatively high-cost power from the project. Finding that Arkansas' express concern was the economic impact on its citizens caused by the utility's participation in the project and the effects of that state's action would have been to shift the burden to the citizens of the other three states, the Court concluded that the Commission's conduct constituted a direct and substantial burden on interstate commerce in violation of the Commerce Clause. Accordingly, it sustained a judgment enjoining the Arkansas Commission from proceeding.

The economic protectionist motives of the NCUC in the instant case could not be clearer. The NCUC's first order (issued before the Court's *NEPCO* opinion) brazenly states that North Carolina consumers are entitled to "first call" on the combined hydroelectric generation of Nantahala and Tapoco, Inc., which includes the inexpensive power supply to the Tennessee facilities. Although subsequent statements of the NCUC and the North Carolina Supreme Court have attempted to disavow the "first call" language, it is apparent from the record of the proceedings that the NCUC orders do in fact result in a preference in favor of North Carolina consumers for this low-cost supply of electricity. Moreover, the North Carolina Supreme Court candidly admitted that the NCUC orders result in the imposition of higher power supply costs on Alcoa's industrial operation in Tennessee (App. 70a).

It is not surprising that a state agency such as the NCUC would favorably consider only the parochial interests of its local constituents. But to allow the NCUC to place those local interests above, and at the expense of, the legitimate interests of a neighboring state, including the Tennessee workers at peril here, would disrupt the functioning of the unified national economy that the Commerce Clause intended to create and protect. Should the NCUC or Nantahala's customers have any legitimate complaint concerning the manner in which Nantahala incurs power supply costs through regulated wholesale rate schedules, a full and effective remedy is available in a federal forum, the Federal Energy Regulatory Commission.

If the decision of the North Carolina Supreme Court is allowed to stand, it will invite similar actions by other states hoping to circumvent orders of the FERC to the

advantage of their own citizens. Yet, those orders were issued on the basis of impartial consideration of competing interests among several states, and the Commerce Clause embodies the judgment of our founders that no one state may perform that office in matters comprehended by the Clause.

CONCLUSION

For the reasons stated above, the Court should note probable jurisdiction and set the case for argument on the merits.

Respectfully submitted:

CARL B. FRANKEL
Counsel of Record
United Steelworkers of
America, AFL-CIO
Five Gateway Center
Pittsburgh, PA 15222
(412) 562-2541

Dated: November 14, 1985

(7)

NO. 85-568

In The

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF FOR THE TOWN OF HIGHLANDS, NORTH CAROLINA, AS *AMICUS CURIAE* SUPPORTING MOTION TO DISMISS OR AFFIRM

JAMES N. HORWOOD
Counsel of Record
DANIEL I. DAVIDSON
CYNTHIA S. BOGORAD
P. DANIEL BRUNER

Attorneys for the Town of Highlands, North Carolina

Law Firm of:
Spiegel & McDiarmid
1350 New York Avenue, N.W.
Washington, D.C. 20005-4798
202-879-4000

November 19, 1985

29

QUESTIONS PRESENTED

1. Is a state preempted from setting a utility's rates to retail customers by "rolling-in" all costs of two integrated utilities (including those costs incurred under FERC-filed rate schedules) and allocating those combined costs to the public on the basis of load, so as to require a utility and its sole stockholder, rather than the utility's ratepayers, to bear the costs of the stockholder's abuse and manipulation of its subsidiary for the stockholder's benefit, where FERC explicitly recognized that the state's determination regarding roll-in may differ from its own, and where FERC itself did not follow the FERC-filed rate schedules in setting that utility's rates to wholesale customers?

2. Is a state precluded by the Commerce Clause from setting retail rates in the above-described manner and placing refund responsibility on the utility and its stockholder, where the sole stockholder is an industrial corporation with a plant located in another state and chooses to attribute the refunds imposed on it to its costs of production in that other state?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Court Cases (continued)

Agency Cases and Decisions

Page

Statutes and Regulations

IN THE

Supreme Court of the United States

October Term, 1985

NO. 85-568

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL, *et al.,*

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF FOR THE TOWN OF HIGHLANDS, NORTH CAROLINA, AS *AMICUS CURIAE* SUPPORTING MOTION TO DISMISS OR AFFIRM

The Town of Highlands, North Carolina, purchases power from Nantahala Power and Light Company ("Nantahala") at wholesale. Highlands was an active participant in the roll-in proceedings at the Federal Energy Regulatory Commission ("FERC") which paralleled the North Carolina Utility Commission ("NCUC") proceedings here appealed.[1] Aluminum Company of America's ("Alcoa") Jurisdictional Statement

---

[1] *Nantahala Power and Light Co.*, Opinion No. 139, 19 F.E.R.C. ¶61,152, *reh'g denied*, Opinion No. 139-A, 20 F.E.R.C. ¶61,430, Opinion No. 139-B, 21 F.E.R.C ¶61,222 (1982), *aff'd, Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984). Highlands also is a key participant in the ongoing litigation before the FERC concerning Appellants' subsequent efforts to contractually separate Nantahala and Tapoco, Inc. *Tapoco, Inc.*, 30 F.E.R.C. ¶63,050, *clarified*, 31 F.E.R.C. ¶63,056 (1985) (exceptions pending).

("J.S.") and the supporting briefs of Tennessee, the Edison Electric Institute ("EEI") and the Federal Amici, seriously mischaracterize the FERC decisions which are so critical to the issues they seek to raise in this Court. Highlands also has an interest in Nantahala's continued ability to serve, and thus a concern that Alcoa should bear any Nantahala retail refund responsibility, and filed an *amicus* brief below.[2]

INTRODUCTION AND COUNTERSTATEMENT OF THE CASE

Alcoa's Jurisdictional Statement and the supporting briefs labor hard to present this case as something it is not. This is not a case of conflict between retail electric regulation in Tennessee and North Carolina, or between the public loads of an electric system in two states. It is not a case in which North Carolina sought to benefit its electric consumers at the expense of electric consumers in other states. It *is* a case in which the NCUC has protected the retail public load of what it found to be an integrated Nantahala/Tapoco electric system, consisting of two North Carolina public utilities, from exploitation by the system's sole shareholder, Alcoa, itself a North Carolina public utility. That Alcoa has benefitted at the public's expense by transferring low-cost power to its aluminum smelter in Tennessee, by means of Tapoco, and that the public customers of the system are located in North Carolina, does not raise substantial Commerce Clause or preemption questions.[3]

[2] Letters from Appellants and Appellees providing consent to file this *amicus* brief have been filed with the Clerk of the Court. Highlands also is a political subdivision of a state within the meaning of Supreme Court Rule 36.4.

[3] Tennessee and EEI argue that the NCUC's roll-in order gives rise to substantial federal questions because the Tennessee regulatory commission might lower Tapoco's rates to Alcoa's Tennessee plant (Tenn. Br. 9; EEI Br. 12). They neglect to mention that Tapoco's rates to Alcoa are not, and have never been, regulated by the Tennessee Public Service Commission. That rate schedule is regulated by the FERC as a rate schedule of a hydroelectric licensee under Part I of the Federal Power Act (16 U.S.C. §§812 and 813; *see also* 18 C.F.R. §35.21 (1985)), and was not at issue in, or affected by, the FERC orders pertinent here (J.S. Appendix ("App.") 309a).

Tennessee also asserts that it "has had no opportunity to participate in the decisions at issue" (Tenn. Br. 4; *see also id.* at 10, 11). In fact, it

Nor is this a case in which the NCUC's regulation of three North Carolina public utilities conflicts with any order of the FERC. Contrary to the assertions of the Federal Amici, FERC Opinion No. 139 did *not* allocate costs between affiliated utilities or between states. The FERC addressed the New Fontana Agreement ("NFA") and the 1971 Apportionment Agreement only in the context of setting Nantahala's rates to three *wholesale* customers. That the FERC exercised discretion to reject rolled-in ratemaking for Nantahala's wholesale rates does not preempt the NCUC from using roll-in for Nantahala's *retail* rates; that the FERC found no abuse of the Federal Power Act does not preempt the NCUC from determining that the three affiliated public utilities have abused North Carolina law. The FERC cannot preempt the NCUC now through a misleading characterization of Opinion No. 139 in a brief; nor can Alcoa do so by choosing to attribute its refund liability to the cost of electricity at its Tennessee smelter.

Conspicuously absent from the briefs of Alcoa and its allies is any mention of the long history of Alcoa's manipulations to obtain low-cost hydroelectric power at the expense of the public, discussed by the North Carolina Supreme Court (J.S. App. 18a-32a). The Nantahala and Tapoco hydroelectric systems are the end result of more than 40 years of corporate organizations, acquisitions and name changes, and transfers of hydroelectric properties among Alcoa, its various subsidiaries and the Tennessee Valley Authority ("TVA"), maneuverings which allocated the least-cost generation to Alcoa's smelter through Tapoco (*id.* at 18a-20a, 23a-24a, 25a-26a). Moreover, Alcoa sought preferred access to even Nantahala's hydroelectric power by purchasing most of Nantahala's output at rates lower than Nantahala's costs *and* lower than its rates to other retail customers. The North Carolina courts ruled that this was unlawful discrimination. *Utilities Comm'n* v. *Mead Corp.*, 238 N.C. 451, 78 S.E.2d 290 (1953), discussed in the decision under review at J.S. App. 26a-28a. At the time it negotiated the NFA,

submitted an *amicus* brief in the appeal to the North Carolina Supreme Court, and its arguments were considered by that Court (J.S. App. 10a, 160a).

Alcoa sought to obtain all of Nantahala's major hydroelectric generation for its own use by selling the distribution system to Duke Power Company. The North Carolina Supreme Court halted the sale. *Utilities Comm'n* v. *Haywood Electric Corp.*, 260 N.C. 59, 131 S.E.2d 865 (1963), discussed in the decision under review at J.S. App. 28a-29a. In the 1960's, Nantahala's public load grew substantially, but Alcoa added no generation to the Nantahala system after the mid-1950's (*see* the discussion in the decision under review, J.S. App. 26a-27a). In 1971, Alcoa ceased purchasing directly from Nantahala, but indirectly appropriated part of Nantahala's generation, through Tapoco, in the 1971 Apportionment Agreement (*id.* at 30a-31a). Nantahala was left to obtain the growing amounts of supplemental power it needed to serve its public load from TVA, whose rates escalated dramatically during the 1970's (*id.* at 31a-32a). Throughout this history, Alcoa engaged in a largely successful effort to evade Federal regulation of its subsidiaries' hydroelectric projects and of the bulk power contracts with TVA, and with and among its subsidiaries, which maximized the usefulness of the Nantahala/Tapoco system resources for aluminum smelting (*id.* at 19a-20a, 21-22a, 29a, 30a, 31a).

In the orders at issue here, the NCUC looked through the structure created by Alcoa and found a single integrated Nantahala/Tapoco system, and domination of Nantahala by its shareholder for the shareholder's benefit and to the injury of Nantahala's ratepayers. To remedy this corporate abuse, the NCUC combined the two systems for ratemaking purposes, and allocated costs to the public using the allocation methodology commonly used for utilities that operate in more than one state. The NCUC then pierced the corporate veil between Nantahala and Alcoa to hold the parent responsible for the injury to the public caused by its actions. *See infra* at pages 9, 13 and 14-15.

In the parallel wholesale rate case, the FERC held that Nantahala's arrangements with its affiliates did not compel roll-in to set just and reasonable rates to Nantahala's three wholesale customers,[4] although it acknowledged the NCUC's earlier use of

[4] Opinion No. 139, J.S. App. 290a-295a; Opinion No. 139-A, J.S. App. 304a-308a.

roll-in to set Nantahala's retail rates.[5] The Court of Appeals affirmed the Federal Commission's roll-in determination as an exercise of ratemaking discretion. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342, 1348 (4th Cir. 1984). The FERC did *not* approve or modify the NFA or the 1971 Apportionment Agreement to determine a just and reasonable allocation of costs between North Carolina and Tennessee or between Tapoco and Nantahala, contrary to the representations in the Jurisdictional Statement and supporting briefs. Opinion No. 139, J.S. App. 298a; Opinion No. 139-A, J.S. App. 309a, 311a.[6] In fact, the FERC stated explicitly that the decision did not affect Tapoco's entitlements under those rate schedules (Opinion No. 139-A, J.S. App. 309a). Rather, in determining the just and reasonable rates for Nantahala is wholesale customers, the FERC found that Nantahala inexplicably had surrendered the greater benefits of an earlier (unfiled) Nantahala-Alcoa apportionment contract without consideration, and that the 1971 Apportionment Agreement was unfair to Nantahala. It therefore set rates as if Nantahala had received more TVA energy than it was entitled to receive pursuant to the 1971 Agreement. Opinion No. 139, J.S. App. 295a-298a; Opinion No. 139-A, J.S. App. 309a, 311a.

I. THE NCUC'S ORDERS RAISE NO SUBSTANTIAL PREEMPTION QUESTION

A. FERC Opinion No. 139 Does Not Preempt The NCUC's Treatment of Federally-Filed Rate Schedules

What is most revealing about the preemption arguments of Alcoa and its allies is their inconsistency regarding what allocation of TVA entitlements they believe the NCUC was required to use in setting retail rates. At times, they seem to be saying

[5] *Compare* the suggestions in the Jurisdictional Statement (at 11, 20), EEI's brief (at 10), and the brief of the Federal Amici (at 4 n.6) that the NCUC rejected or "collaterally attacked" an earlier FERC determination (*but see* J.S. 9 n.11).

[6] Indeed, the 1971 Apportionment Agreement was not even filed with the FERC by Nantahala and Tapoco until 1980 — four years after

that the NCUC is required to use the FERC-filed rate — the 1971 Apportionment Agreement — in setting retail rates.[7] At other times, they criticize the NCUC for failing to follow the cost allocation utilized by the FERC in Opinion No. 139.[8] The problem is that the filed rate is *not* the same as the entitlements FERC imputed in setting rates to Nantahala's three wholesale customers.

This confusion in the briefs of Alcoa and its allies demonstrates that their preemption arguments proceed from a fundamental mischaracterization of Opinion No. 139. This is *not* a case where FERC "expressly approved different interstate allocations of the power and wholesale costs" (J.S. 18).[9] In Opinion No. 139, FERC left the "interstate allocations" — the filed rate — unchanged, but *departed* from those allocations in order to achieve just and reasonable rates to Nantahala's three wholesale customers. Rather than reviewing the interutility transactions in its role as regulator of bulk power transactions, FERC in Opinion No. 139 viewed them in its role as regulator of Nantahala's rates to its three wholesale customers, a role parallel to the NCUC's role in setting Nantahala's rates to retail customers.[10] In its Order Denying Rehearing, FERC emphasized that in Opinion No. 139 it acted only in the context of establishing just and reasonable rates for wholesale customers and was not purporting to allocate interstate power flows or costs:

Nantahala filed its wholesale rate increase — and even then it was filed only under protest (*see* the North Carolina Supreme Court's discussion at J.S. App. 31a).

[7] *See, e.g.,* J.S. 16-17; Fed. Br. 8; EEI Br. 11.

[8] *See, e.g.,* J.S. 17-18; Fed. Br. 6; EEI 8, 15; Tenn. Br. 5-6.

[9] *See also* the erroneous proclamation of the Federal Amici (Br. 6) that "The Federal Energy Regulating [sic] Commission has made determinations pursuant to its unquestioned authority over wholesale transactions concerning how 'entitlements' to certain power, received in return for other power, should be divided between two utilities, serving neighboring states."

[10] *Compare* Alcoa's assertion that the NCUC and the FERC disagreed over whether the NFA and 1971 Apportionment Agreement and Nantahala's TVA purchases benefitted retail ratepayers (J.S. 19).

> Docket No. ER76-828 originated with a proposed rate increase by Nantahala under its Rate Schedule PL, which governs charges to customers using electric service for resale. That proposed rate increase was set for hearing under both Sections 205 and 206 of the Federal Power Act [16 U.S.C. §§824d and 824e], thus giving the Commission authority to order refunds should it find Nantahala's rates were not just and reasonable. In Opinion No. 139 the Commission found the proposed charges were not just and reasonable. Among the reasons for our finding was that the 1971 Apportionment Agreement . . . does not afford Nantahala its fair share of NFA energy entitlements, and the rates under Rate Schedule PL are directly affected by the amount of entitlements received by Nantahala. The Commission specifically stated that it was not reforming the 1971 Apportionment Agreement. Instead, the Opinion sets rates for Nantahala as though it had received its fair share of entitlements. The Commission properly acted under Section 205 of the Federal Power Act in setting just and reasonable rates.

Opinion No. 139-A, J.S. App. 310a-311a. The FERC then added: "[W]e have not modified Nantahala's contracts [under Section 206]. Instead, we have set just and reasonable rates under our powers under Section 205" (*id.* at 312a).[11] FERC's actions therefore are of a completely different nature than the exercise of Federal authority to divide power between two states. Under these circumstances, there is no substantial preemption question.

The argument that preemption and the filed rate doctrine preclude the NCUC from protecting retail ratepayers pursuant to North Carolina law by allocating costs to the public on a basis other than the literal terms of the 1971 Apportionment Agreement is untenable. Alcoa and its allies in effect claim that while the FERC in setting rates to wholesale ratepayers can

[11] *Compare* J.S. 18, where Alcoa characterizes Opinion No. 139 as acting under Section 206 of the Act, "approv[ing] different interstate [power] allocations . . ." *See also* J.S. 7-8.

decline to follow the filed rate so as to make wholesale rates just and reasonable under the Federal Power Act, North Carolina cannot treat the same agreements in the same manner to achieve what it concluded are just and reasonable retail rates. The FERC did *nothing* to protect Nantahala's retail customers. This argument would leave them completely unprotected from what both Federal and North Carolina authorities found to be unreasonable costs. The preemption doctrine does not compel such oppression. In setting rates to wholesale customers, FERC is as bound by the filed rate doctrine as is a state commission.[12] Because that doctrine did not prevent FERC from setting wholesale rates on another basis, it does not require the NCUC to pass through to Nantahala's retail ratepayers the full cost of the 1971 Apportionment Agreement.

Nor is there any basis for concluding that the FERC intended to require the NCUC to use for retail ratemaking purposes the same assumed entitlements that it used for wholesale rates. There is no question that states in setting rates to retail customers and the FERC in setting rates to wholesale customers may use different ratemaking methodologies. *Public Systems* v. *FERC*, 709 F.2d 73, 84 (D.C. Cir. 1983). Opinion No. 139 amply illustrates the wide yet accepted divergence between the ratemaking policies of these two jurisdictions.[13]

Nor can it be seriously asserted that the Federal Power Act preempts states from applying their own laws and policies regarding abuse by public utilities. In determining whether roll-in was appropriate for setting Nantahala's wholesale rates, FERC expressed "[t]he central question . . . [as] whether . . . Alcoa has used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act" (Opinion No. 139, J.S. App. 290a) — whether an industrial

[12] *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 578 (1981); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956).

[13] The FERC rejected an NCUC-accepted treatment of amortization of Nantahala's major generating facilities (19 F.E.R.C. at pp. 61,286-87; 20 F.E.R.C. at pp. 61,872-74), and an NCUC-accepted purchased power adjustment clause. Their methods for determining rate base and rate of return differ significantly. *Compare* 19 F.E.R.C. at pp. 61,285-86 *with* the NCUC order, J.S. App. 222a-226a.

company not itself a "public utility" under Part II of the Federal Power Act[14] had used jurisdictional subsidiaries to frustrate the Act. In contrast, the NCUC was applying North Carolina law regarding abuse and domination by Alcoa, a North Carolina public utility, of its integrated North Carolina public utility subsidiaries.[15] Thus, in the words of the North Carolina Supreme Court (J.S. App. 90a), the NCUC

> determined that it was inappropriate to allow Nantahala to collect all of its revenue requirements from its public customers on the theory that it was a stand-alone company, because Nantahala's "stand-alone" costs under the corporate and contractual arrangements were not incurred for their benefit, but as a result of Alcoa's corporate dominance for Alcoa's benefit.

Indeed, in Opinion No. 139-A, the FERC expressly acknowledged that although it declined to use roll-in for wholesale ratemaking pursuant to the Federal Power Act, North Carolina applying State criteria could validly require roll-in (J.S. App. 305a):

> We recognize that the North Carolina Utilities Commission (NCUC), based on a similar record, reached a different conclusion concerning rolled-in costing. However, the question of whether to treat various entities as an integrated system for ratemaking purposes is not a purely factual question, but also rests on criteria which each ratemaking authority may deem relevant.

To require the NCUC to adhere to the precise entitlements that the FERC imputed to Nantahala would be to single out and remove from its context one of the package of adjustments

[14] *Alcoa Generating Corporation*, 5 F.E.R.C. ¶61,133 at p. 61,323 (1978). Highlands has consistently maintained that Alcoa should be found jurisdictional under Part II of the Federal Power Act.

[15] The FERC stated that it gave no weight to Tapoco's status as a public utility under North Carolina law (Opinion No. 139, J.S. App. 293a & n.21).

ordered by FERC to achieve what it found to be just and reasonable wholesale rates under the Federal Power Act. For example, because Nantahala failed to follow FERC regulations regarding automatic adjustment clauses, the FERC disallowed Nantahala's purchased power adjustment clause ("PPAC").[16] This operated to disallow from wholesale rates certain costs of Nantahala's TVA purchases in addition to the TVA power costs disallowed by the imputation to Nantahala for ratemaking purposes of energy entitlements greater than those contained in the 1971 Apportionment Agreement. Would the NCUC also be required to reject Nantahala's retail PPAC, which was otherwise acceptable under North Carolina standards? The wholesale ratemaking package chosen by FERC for 7% of Nantahala's sales could well require refunds exceeding Nantahala's net worth if applied on a total-company basis without provision for reimbursement by Alcoa. The preemption doctrine requires no such result. The FERC's imputed entitlements no more bind the NCUC than the FERC's choice of rate of return.

Thus, Opinion No. 139 did not bind the NCUC either to rigid application of the filed rate that the FERC itself found unfair, or to application of the imputed entitlements approach that the FERC adopted (together with other adjustments) to achieve what it found to be just and reasonable wholesale rates. The FERC explicitly left it open to the NCUC to adopt roll-in to protect retail ratepayers.

B. The NCUC and North Carolina Supreme Court Decisions Are Entirely Consistent with the *Narragansett* Doctrine

The arguments that the North Carolina decisions are inconsistent with the *Narragansett* doctrine,[17] and the attempts to cast those decisions as episodes in a doctrinal controversy that requires resolution by this Court, are based on the premise that

[16] 19 F.E.R.C. at pp. 61,283-85; 20 F.E.R.C. at pp. 61,871-72; Opinion No. 139-B, 21 F.E.R.C. ¶61,222 at p. 61,500 (1982). These pages were not included in the Appendix to the Jurisdictional Statement.

[17] *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978). A number of cases in the

North Carolina defied an FERC allocation of costs between Nantahala's ratepayers in North Carolina and Tapoco's ratepayer (Alcoa) in Tennessee. As discussed above, this is *not* what the FERC did in Opinion No. 139. Thus, EEI's argument (Br. 8-12) that a state commission cannot use roll-in and traditional allocation methodologies if the resulting retail rates do not reflect all costs allocated to each utility through FERC review of an inter-utility power contract, even if valid, is irrelevant here. Because this case does not at all fit the mold of cases where state commissions interfered with or defied FERC interstate power costs allocations, it is an entirely inappropriate vehicle for the review of whatever controversies may be developing in those areas.

This case falls squarely within the line of state *and FERC* cases which recognize that the FERC may leave to the states determination of the prudence of power costs incurred by a utility under a wholesale contract, or the need for those costs to be incurred to serve retail ratepayers, and that state commissions and the FERC may reach different conclusions with regard to a utility's rates to its retail and wholesale customers.

In *Appeal of Sinclair Machine Products, Inc.*, No. 84-380 (N.H. July 26, 1985) (available on LEXIS, States library, NH file), the New Hampshire Supreme Court reversed the state commission for accepting in a retail rate case a utility's wholesale power purchases from its parent without scrutiny. The court held that although the state commission could not inquire into the reasonableness of the FERC-determined wholesale rate, "the PUC may always inquire into the reasonableness of a utility's purchasing power under a FERC-approved rate given other purchase options available to the utility." *Id.*, slip op. at 2. The court relied on FERC cases which neither Alcoa nor its allies mention. These cases hold that the FERC's determination that a bulk power transaction is just and reasonable does not prejudge a later prudence determination by either the state commission in considering whether the costs associated with such

Narragansett line are cited at pages 4, 14, and 18-19 of the Jurisdictional Statement, pages 10-11, and 13-14 of the EEI brief, page 7 of the Federal Amici brief, and page 9 of the Tennessee brief.

transaction should be passed through to utility's retail customers, or the FERC in separately considering whether these costs should be passed through to a utility's sale for resale customers. *Id.*, slip op. at 8-9, quoting *Philadelphia Electric Co.*, 15 F.E.R.C. ¶ 61,264 at p. 61,601 (1981), and *Pennsylvania Power & Light Co.*, 23 F.E.R.C. ¶ 61,006 at p. 61,009 (1983).[18] The New Hampshire court expressed the preemption doctrine as requiring

> examin[ation of] those matters *actually determined*, whether expressly or impliedly, by the FERC. As to those matters not resolved by the FERC, State regulation is *not preempted provided that* State regulation would not contradict or undermine FERC determinations and federal interests, or impose inconsistent obligations on the utility companies involved.

Id., slip op. at 9 (emphasis in original). The court then closely scrutinized the pertinent FERC orders, concluding that they did not preempt the state commission from determining the "reasonableness or prudency" of the utility's purchases. *Id.*, slip op. at 11.[19]

[18] *Accord, AEP Generating Co.*, 29 F.E.R.C. ¶61,246 at p. 61,501 (1984); *Southern Company Services, Inc.*, 26 F.E.R.C. ¶61,360 at p. 61,795 (1984); *Southern Company Services, Inc.*, 20 F.E.R.C. ¶61,332 at p. 61,694 (1982).

In *American Electric Power Service Corp.*, 32 F.E.R.C. ¶61,363 (1985) (rehearing pending), the FERC held that its determination of the justness and reasonableness of a transmission agreement that was integral to the operations of a multistate holding company power pool, subject to FERC and Securities and Exchange Commission jurisdiction, *would* preempt the states from considering the prudence of the transmission agreement. The FERC found that, in those circumstances, resolution of the transmission agreement controversies would leave nothing for the states to decide. 32 F.E.R.C. at pp. 61,817-19. Therefore, *American Electric Power Service* is completely unlike Opinion No. 139.

[19] *Accord, Pike County Light and Power Co.* v. *Pennsylvania Public Service Comm'n*, 77 Pa. Commw. 268, 465 A.2d 735 (Pa. Commw. Ct 1983). Although Alcoa characterizes this case as an exception to the general preemption rule (J.S. 20 n.28), *Pike County* is squarely within a well-established line of cases that are entirely consistent with those cases where state commissions have been reversed for overriding actual or potential FERC determinations of reasonableness.

Opinion No. 139 illustrates the principle underlying *Sinclair* and the FERC cases on which it relies. The FERC did not modify the 1971 Apportionment Agreement, but disallowed certain costs associated with that contract as not prudently incurred by Nantahala (Opinion No. 139-A, J.S. App. 312a). The NCUC determined that Nantahala was not even capable of prudent action on behalf of its ratepayers. It found Nantahala not to be an independent utility under North Carolina law, because it was developed as part of a single system by Alcoa and completely subjected to Alcoa's domination (*see* the NCUC's roll-in order at J.S. App. 233a). EEI's argument that the cases leaving questions of prudence and need for power to the states are not applicable to the NCUC's decision "because the prudence of Nantahala's power supply arrangements is not questioned" (EEI Br. 13 n.9) is utterly meritless.

EEI's radical attempt to curtail the jurisdiction of states to protect their citizens from corporate abuse resulting in excessive retail rates, by arguing that the NCUC was preempted from piercing the corporate veil, has absolutely no support in the case law. The NCUC did not use roll-in to defeat or disallow any FERC allocation of costs to North Carolina or Nantahala; the FERC did not approve or modify the NFA and 1971 Apportionment Agreement so as to fix Nantahala's just and reasonable purchased power costs for retail purposes. Thus, the cases on which EEI relies (Br. 12-14) are inapplicable here.[20]

See also Public Service Co. of Colorado v. *Public Utilities Comm'n of Colorado*, 644 P.2d 933 (Colo. 1982), where the Colorado Supreme Court held that the Colorado commission was not preempted from inquiring into whether a natural gas pipeline's R&D costs, incurred under FERC-approved wholesale rate schedules, were incurred for the benefit of retail ratepayers, or instead to benefit shareholders.

The extent of EEI's misunderstanding of the North Carolina decisions it asks this Court to review is revealed by its argument that the Colorado case is inapplicable because it concerned R&D expenditures and not power generation costs, which were involved in cases such as *Northern States Power Co.* v. *Minnesota Public Utilities Comm'n*, 344 N.W.2d 374 (Minn.), *cert. denied*, 104 S. Ct. 3546 (1984), and *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981) (EEI Br. 9-11, 10 n.7). The point is not the *types* of costs involved, but *why* and how they were approved or disapproved at the Federal and state levels.

[20] In *Sinclair Machine Products, supra*, slip op. at 12, the New

II. THE NCUC'S ORDERS RAISE NO SUBSTANTIAL QUESTION UNDER THE COMMERCE CLAUSE

Alcoa characterizes the NCUC's order as an attempt to give

> North Carolina customers a disproportionate and ever-increasing preference to the economic benefits of inexpensive hydroelectric power...[,] requir-[ing] Tapoco's Tennessee customer to pay "refunds" equivalent to the higher cost of power it has allocated to Tennessee ..., thereby explicitly transfer[ing] economic benefits from Alcoa's plant in Tennessee to Nantahala's North Carolina customers and inhibit[ing] the exportation of hydroelectric power generated in North Carolina to Tennessee.

J.S. 21. This completely misconstrues the nature of the NCUC's orders and, in particular, the NCUC's explicit determination to hold Alcoa, *as Nantahala's dominating stockholder*, not as Tapoco's customer, responsible for manipulating its public utility subsidiaries to the detriment of the North Carolina public. Alcoa's attempt to insulate its abuses of North Carolina law from regulatory scrutiny by hiding behind the Commerce Clause should be rejected.

The NCUC's retail rate order neither intended nor resulted in economic protectionism or regulation of interstate commerce. The NCUC's establishment of retail rates by combining the

Hampshire Supreme Court held that the state commission could not use a piercing of the corporate veil rationale to disallow flowthrough of abandoned nuclear plant costs that the FERC had determined should be flowed from one utility to its retail subsidiary. In *Office of Public Counsellor* v. *Indiana and Michigan Electric Co.*, 416 N.E.2d 161, 164-65 (Ind. App. 1981), an Indiana intermediate appellate court held that where the FERC regulated sales to a utility by its nuclear generation subsidiary, a state commission could not use roll-in to reduce the FERC-determined rate of return received by the subsidiary for those sales. More generally, several cases hold that a state cannot disregard or disallow costs incurred by a utility under FERC-jurisdictional rate schedules *merely* on the grounds that the wholesale transactions involve affiliated companies. *See, e.g., United Gas Corp.* v. *Mississippi Public Service Comm'n*, 127 So.2d 404, 420 (Miss. 1961) (discussed at EEI Br. 13 n.10).

costs of Nantahala and Tapoco, and allocating to the public its proportionate share of the joint costs — as it does for every other utility operating in more than one state (*see* the North Carolina Supreme Court's discussion, J.S. App. 16a, 101a) — rested on factual findings well within the traditional purview of a retail commission. Roll-in was based on findings, as affirmed and summarized by the North Carolina Supreme Court, that Tapoco and Nantahala are North Carolina public utilities and that

> (a) Nantahala has not been designed, developed and operated as a stand-alone electric system, (b) the Nantahala and Tapoco electric facilities constitute a single integrated electric system, and (c) the two corporate affiliates should be treated as a single utility system for rate making purposes, in view of their historical development, actual operating conditions and the fact that Nantahala's customer cost responsibility cannot be accurately determined using a "stand-alone" model....

J.S. App. 136a-137a. The NCUC found that Alcoa dominated Nantahala, so that Nantahala was incapable of protecting its ratepayers, and therefore pierced the corporate veil and held Alcoa, as Nantahala's stockholder, responsible for the refunds which exceeded Nantahala's ability to pay (J.S. App. 233a).

It has long been recognized that when the interests of a regulated company are subordinated to an affiliate so as to benefit private interests to the injury of the public the regulatory scheme was designed to protect, it may be appropriate or necessary to pierce the corporate veil to halt and redress the injury.[21] Here, the NCUC has acted appropriately under North Carolina law to protect the interests of retail ratepayers because Alcoa has not behaved as a mere investor of Nantahala, but

[21] *See, e.g., Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 606-08 (1945); *United Fuel Gas Co.* v. *Railroad Comm'n of Kentucky*, 278 U.S. 300, 320-21 (1929); *Chicago, Milwaukee & St. Paul Ry.* v. *Minneapolis Civic & Commerce Ass'n*, 247 U.S. 490, 500-01 (1918); *see also Western Distributing Co.* v. *Public Service Comm'n of Kansas*, 285 U.S. 119, 124-25 (1932). *And see* the North Carolina Supreme Court's discussion, J.S. App. 113a.

rather, manipulated Nantahala and Tapoco to procure for itself low-cost power.[22]

State commissions plainly may act, without offending the Commerce Clause, to protect ratepayers from imprudent actions of public utilities, utility acquisitions that are not used and useful for retail ratepayers, or unreasonable costs imposed by inter-affiliate manipulations. Any disallowance of costs will have an impact on the company and its stockholders. The geographical location of the stockholders and their other interests does not create a Constitutional bar against a state commission's protection of retail ratepayers in this manner.

Moreover, the NCUC's orders have only an incidental effect on interstate commerce. The NCUC's orders are directed against Nantahala in the first instance. They are an unexceptional example of a state disallowing costs not incurred for the benefit of ratepayers. The NCUC went on to pierce the corporate veil, to require Alcoa to pay refunds exceeding Nantahala's ability to pay, but it expressly stated that this neither required nor contemplated any effect on Tapoco's rates to Alcoa (J.S. App. 241a, 243a). That Alcoa is both Nantahala's stockholder and Tapoco's customer, and that Alcoa's purpose in manipulating its subsidiaries has been to obtain benefits through Tapoco's sales to Alcoa's smelter, does not make refunds a cost of purchasing Tapoco power. Alcoa's choice of internal accounting methods certainly does not implicate the Commerce Clause.

Thus, the NCUC's orders do not impermissibly interfere with interstate commerce under the standards set forth in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970). Where a state "regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." 397 U.S. at 142 (citation omitted). The incidental burden on interstate commerce here cannot outweigh North Carolina's strong interest in effective utility regulation. *See, e.g.*,

---

[22] *See* the North Carolina Supreme Court's discussion, J.S. App. 113a-122a. *See also United States* v. *Reading Co.*, 253 U.S. 26, 48, 60-63 (1920); *Chicago, Milwaukee & St. Paul Ry.* v. *Minneapolis Civic & Commerce Ass'n, supra*, 247 U.S. at 500-01. Indeed, the North Carolina Supreme Court held that the statute that makes Alcoa a North Carolina public utility insofar as its ownership and control of Nantahala affects the latter's rates is designed to facilitate review and remedy of such abuses as were found in this case (J.S. App. 44a-54a, 110a-112a).

Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Comm'n*, 461 U.S. 375, 377, 394-95 (1983).[23]

The NCUC's actions are not at all comparable to the economic protectionism held unconstitutional in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982) ("NEPCO"). The NCUC did not prohibit the export of North Carolina hydroelectric power, or the economic benefits of such power, so as to retain that power for in-state residents. It only established Nantahala's retail rates in a manner which assures Nantahala ratepayers a fair allocation of the Nantahala/Tapoco resources, and does not disproportionately burden them with the costs of Alcoa's manipulations. No wholesale sales were ordered, and no changes in wholesale rates were the necessary consequence of the NCUC's orders. Moreover, in *NEPCO*, the state action forced the utility to incur a loss if it continued to sell hydroelectric power out-of-state; this loss served no legitimate (non-protectionist) state interest. There *is* an important state interest in requiring Alcoa, Nantahala's stockholder, to bear the costs incurred for its benefit and not for the benefit of the public load.

In *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, No. 84-2409 (8th Cir. August 23, 1985) (printed at J.S. App. 320a-344a), the Arkansas Commission explicitly sought to defy FERC orders requiring Arkansas Power & Light Company to share with its affiliates in other states the costs of a nuclear project. The NCUC's effort to protect public rate-

---

[23] Federal Amici appear to agree that if the NCUC's orders are not protectionist (which they are not), they would pass muster under *Bruce Church* (Fed. Br. 11). Their apparent suggestion that this Court use this case to reconsider well-established Commerce Clause tests in favor of what appears to be no test at all (Fed. Br. 12-13) is entirely inappropriate. The alleged "competing state interests" (Fed. Br. 12) boil down to Alcoa's efforts to escape the costs of its self-dealing.

payers from what it found to be the detrimental effects of Alcoa's dominance thus is not comparable to the Arkansas Commission's efforts to keep high-cost power out of Arkansas.

Alcoa and its allies place great emphasis on the NCUC's "first call" language in their effort to portray the NCUC's actions as economic protectionism. As explained by the North Carolina Supreme Court (J.S. App. 101a-103a), this language is neither the basis for nor the effect of the NCUC's orders.

Alcoa points to the NCUC's refusal to roll-in Alcoa's separate TVA purchases (J.S. 10). However, even Alcoa characterizes these purchases as among the sources of power for "Tapoco/ Alcoa and Nantahala" (J.S. 10 n.13), not for the integrated Tapoco/Nantahala system the NCUC was addressing. As found by the NCUC, TVA's direct sales to Alcoa are not part of Tapoco's utility operations, and even if they were, the cost of such specialized purchases would be separately assigned to Alcoa under standard allocation methodology (*see* the North Carolina Supreme Court at J.S. App. 65a-66a, and the NCUC at 211a-215a). The NCUC's finding against Alcoa on this question of fact and ratemaking policy does not raise any federal question.

Alcoa next complains that the NCUC's allocation of the Nantahala/Tapoco costs on the basis of Nantahala's "ever-increasing" demand for power somehow constitutes a "first call" on hydroelectric power (J.S. 10). There is nothing extraordinary about allocating system costs on the basis of load (*supra* at 14-15). That Nantahala's load is increasing as compared with Alcoa's partial requirements purchases from Tapoco simply means that Nantahala's ratepayers gradually will bear a greater proportion of the costs of all Tapoco/Nantahala resources (which will gradually include more TVA purchases). The NCUC's refusal to allocate costs on the basis of "Nantahala's contribution," as determined by Alcoa through its manipulation of the hydroelectric properties of its subsidiaries and through the contracts the NCUC has found detrimental to Nantahala's interests, does not evince economic protectionism but rather protection of ratepayers from abuse by the utility's industrial parent.

Contrary to Alcoa's claims (J.S. 10-11), the NCUC's use of the Nantahala/Tapoco system capacity rather than the NFA entitlements as the basis for its allocations does not provide North Carolina with "first call" on hydroelectric power. The NCUC found that in the NFA, Alcoa traded away the much larger system capacity of Nantahala and Tapoco to obtain entitlements peculiarly suited to its needs and of no value to the public (*see* the North Carolina Supreme Court's discussion at J.S. App. 67a-68a, 102a-103a). The NCUC's determination not to charge ratepayers for Alcoa's trade that achieved entitlements neither used nor useful to serve Nantahala's load does not constitute economic protectionism.[24]

Thus the NCUC's orders serve legitimate and substantial local interests with only incidental and not excessive effects on interstate commerce. They therefore raise no substantial question under the Commerce Clause.

---

[24] Nor is Alcoa's argument advanced by the North Carolina Supreme Court's remand instructions that the NCUC consider whether Nantahala's customers would benefit from roll-in. *North Carolina ex rel. Utilities Commission* v. *Edmisten*, 299 N.C. 432, 442-43, 263 S.E.2d 583, 591 (1980). Requiring utility commissions to set rates to consumers at the lowest reasonable rate is neither extraordinary (*e.g., Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, 388 (1959)) nor an impermissible intrusion on interstate commerce.

CONCLUSION

Alcoa's appeal should be dismissed or the NCUC orders should be summarily affirmed.

Respectfully submitted,

JAMES N. HORWOOD
DANIEL I. DAVIDSON
CYNTHIA S. BOGORAD
P. DANIEL BRUNER

Attorneys for the Town of Highlands, North Carolina

Law Firm of:
Spiegel & McDiarmid
1350 New York Avenue, N.W.
Washington, D.C. 20005-4798

November 19, 1985

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY, *et al.*,
Appellants,

v.

STATE OF NORTH CAROLINA ex rel.
UTILITIES COMMISSION, *et al.*,
Appellees.

On Appeal from the Supreme Court
of North Carolina

JOINT APPENDIX

REX E. LEE*
DAVID W. CARPENTER
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000

RONALD D. JONES
DAVID R. POE
M. REAMY ANCARROW

EDWARD S. FINLEY, JR.
WILLIAM D. JOHNSON
GRADY L. SHIELDS

Attorneys for Appellants

WILLIAM T. CRISP*
ROBERT F. PAGE
Post Office Box 751
Raleigh, N.C. 27602
(919) 833-2556

LACY H. THORNBURG,
Attorney General
RICHARD L. GRIFFIN
N. C. Department of Justice

JAMES D. LITTLE
The Public Staff

Attorneys for Appellees

*Counsel of Record

JURISDICTIONAL STATEMENT FILED SEPTEMBER 30, 1985
PROBABLE JURISDICTION NOTED DECEMBER 9, 1985

TABLE OF CONTENTS

STATEMENT OF OMITTED MATERIALS

The following opinions have been omitted in printing this appendix because they appear on the following pages in the Appendix to the Jurisdictional Statement:

CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

DOCKET OF THE NORTH CAROLINA UTILITIES COMMISSION

Date	Proceedings
June 14, 1976	Letter of Intent to File an Application for General Increase in Rates and Charges filed with the North Carolina Utilities Commission
November 3, 1976	Application for General Increase in Rates and Charges filed in North Carolina Utilities Commission Docket No. E-13, Sub 29
November 3, 1976	Data Filing
November 3, 1976	Testimony and Exhibits of William M. Jontz filed
November 3, 1976	Testimony and Exhibits of Joseph F. Brennan filed
November 3, 1976	Testimony and Exhibits of Edward C. Oelsner, III filed
November 3, 1976	Testimony and Exhibits of George Popovich filed
November 3, 1976	Testimony and Exhibits of J. Breitling filed
November 3, 1976	Testimony and Exhibits of Robert D. Buchanan filed
November 3, 1976	Testimony and Exhibits of S. R. Clammer filed
November 3, 1976	Information from Accounting (Bob Branch) sent to Accounting dated September 23, 1976

Date	Proceedings
November 10, 1976	Request that Commission not change the test year (Calendar Year 1975) to a later period filed
November 22, 1976	Order Setting Investigation and Hearing, Suspending Proposed Rates, and Requiring Public Notice
November 24, 1976	Order Resetting Hearing
November 24, 1976	Notice of Intervention by Attorney General of North Carolina
November 26, 1976	Order Recognizing Intervention of Attorney General
February 1, 1977	Filing of Resolution of Swain County Board of Commissioners in Opposition to Proposed Rate Increase, and Requesting that Hearing be held in the Nantahala Distribution Area
February 8, 1977	Request for Room Reservation filed
February 10, 1977	Order Changing Location of Hearing
February 10, 1977	Motion by Attorney General for Hearing in Distribution Area filed
February 15, 1977	Room Confirmation for March 15 in Bryson City
February 23, 1977	Testimony and Exhibits of Eugene H. Curtis, Jr. Edwin A. Rosenburg, J. Reed Bumgarner, Andrew W. Williams, N. Edward Tucker and William E. Carter, Jr. filed
March 2, 1977	Order Changing Times and Places of Hearing

Date	Proceedings
March 8, 1977	Protest Petition mailed
March 9, 1977	Protest Petition mailed
March 22, 1977	Petition to Intervene by the Swain County Board of County Commissioners filed
March 24, 1977	Petition to Intervene by Henry J. Truett filed
March 28, 1977	Petition to Intervene by the Board of Aldermen of the Town of Bryson City filed
April 4, 1977	Transcript of Testimony Volumes III and V mailed
April 6, 1977	Correspondence from Clark Crampton filed
April 8, 1977	Transcript of Testimony Volumes I and II mailed
April 12, 1977	Transcript of Testimony Volume VI mailed
April 19, 1977	Copies of Correspondence from Clark Crampton to Boltch, Griffin (Office of the Attorney General) and Pachnowiski, Attorney, Bryson City filed
April 20, 1977	Transcript of Testimony Volumes V and VII mailed
April 21, 1977	Copy of Correspondence to Barbara Simpson, filed
April 22, 1977	Transcript of Testimony Volume IX mailed
May 5, 1977	Correspondence from Commissioners of Jackson County filed

Date	Proceedings
May 5, 1977	Surrebuttal Testimony submitted on behalf of the Office of the Attorney General of North Carolina, and Intervenors Bryson City, Swain County, and Henry Truett
May 9, 1977	Deposition Submitted by Commissioners of Jackson County
May 11, 1977	Memorandum from D. Allen filed
May 12, 1977	Documentation of cases of Land Purchase Foreclosures used for Land Acquisition filed
May 23, 1977	Brief and Proposed Findings of Fact and Conclusions of Law of Intervenors Bryson City and Swain County filed
May 23, 1977	Memorandum from Dwight Allen filed
May 24, 1977	Attorney General's Brief in Opposition filed
May 25, 1977	Brief of Nantahala Power and Light Company filed
May 25, 1977	Brief on Behalf of Intervenor Henry J. Truett filed
June 14, 1977	Order Granting Partial Rate Increases and Denying Motion
July 13, 1977	Filing of Exceptions, Notice of Appeal, and filing of Motion for Further Hearing
July 19, 1977	Order Noting Exceptions and Notice of Appeal for the Records of the Commission and Denying Motion for Further Hearing

Date	Proceedings
July 29, 1977	Motion for Extension of Time for Filing and Record on Appeal filed
August 1, 1977	Order Granting Extension of Time for Filing Record on Appeal
September 8, 1977	Nantahala Comments and Proposed Load Research Study Plan Prepared by Ebasco Services Incorporated filed
October 27, 1977	Attorney General Motion for Additional Extension of Time for Filing Record and Case on Appeal filed
November 1, 1977	Order Allowing Extension of Time for Filing and Settling Record and Case on Appeal
November 28, 1977	Attorney General's Proposed Record on Appeal filed
November 28, 1977	Attorney General Motion for Extension of Time within which Applicant May Serve and File Approval, or Objections or Proposed Alternative Record on Appeal, and for Additional Extension of Time within which to Complete Settlement of Record on Appeal filed
November 30, 1977	Order Allowing Extension of Time
December 9, 1977	Copy of Order Entered by the North Carolina Court of Appeals
January 6, 1978	Nantahala's Alternate Proposed Record on Appeal filed

Date	Proceedings
January 16, 1978	Request for Conference to Settle Record on Appeal Attorney General
January 23, 1978	Order Setting Conference to Settle Record on Appeal
February 3, 1978	Report and Order on Conference to Settle Record on Appeal
February 6, 1978	Transcript of the Conference on Record on Appeal filed
February 20, 1978	Letter from Maurice Horne filed
April 12, 1978	Protest Letter filed
March 27, 1979	Opinion and Judgment from the North Carolina Court of Appeals filed
April 2, 1979	Undertaking to Reimburse filed
April 11, 1979	Certificate of Satisfaction from the North Carolina Court of Appeals filed
August 28, 1979	Notice to Chief Clerk of Prepared Certified Copy of the record in the above case and delivered to Clerk's Office
April 1, 1980	Certification of Judgment Case on Remand
May 9, 1980	Motion for Rehearing before the Full Commission filed on behalf of the Attorney General's Office
May 14, 1980	Motion to Join Alcoa and Tapoco, Inc. as Parties filed on behalf of the Attorney General's Office

Date	Proceedings
May 14, 1980	Motion for Hearing Respecting Applicant's Ability to Refund Possible Overcharges filed on behalf of Attorney General's Office
May 14, 1980	Motion for Prehearing Conference filed on behalf of the Attorney General's Office
May 19, 1980	Certificate of Satisfaction of costs in the Court of Appeals filed
May 19, 1980	Applicant's Response to Motion for Rehearing before the Full Commission filed
May 23, 1980	Order Allowing Extension of Time to File Answers
May 27, 1980	Letter from Aluminum Co. of America, Inc. seeking opportunity to respond to motion with intent to submit response filed
May 27, 1980	Response to motion regarding order granting time to June 4, 1980 to file response to motion to Join Alcoa and Tapoco, Inc. as parties filed
June 4, 1980	Alcoa's Response to Motion to Join Alcoa and Tapoco, Inc. as Parties filed
June 4, 1980	Tapoco, Inc.'s Response to Motion to Join Alcoa and Tapoco, Inc. filed
June 4, 1980	Nantahala Power & Light Company's Response to Motion for Prehearing Conference filed

Date	Proceedings
June 4, 1980	Nantahala Power & Light Company's Response to the Motion for Hearing Respecting Applicant's Ability to Refund Possible Overcharges filed
June 4, 1980	Nantahala Power & Light Company's Response to the Motion to Join as Parties filed
June 24, 1980	Order Setting Motions and Responses for Oral Argument
June 27, 1980	Intervenor's Reply to applicant's response to motion for rehearing before the full commission filed by Attorney General's office
June 27, 1980	Intervenor's reply to applicant's response to motion for refund of possible overcharges filed
July 15, 1980	Letter from Alcoa and Tapoco in connection with the supplying of information and witnesses per hearing connected with Court of Appeals and Supreme Court filed
July 29, 1980	Order Setting Hearing and Requiring Data and testimony
July 31, 1980	Answer to applicant to reply to response filed
August 19, 1980	Order scheduling hearing
August 26, 1980	Transcript of Testimony and Oral Argument mailed
August 27, 1980	Public Staff's Notice of Intervention filed

Date	Proceedings
August 29, 1980	Letter on behalf of Intervenor Swain County filed
September 4, 1980	Letter from Attorney General in response to Undertaking to refund filed
September 4, 1980	Letter on behalf of Nantahala in response to Undertaking to refund filed
September 5, 1980	Transcript of Testimony Volume I mailed
September 5, 1980	Transcript of Testimony Volume II mailed
September 5, 1980	Memorandum of Public Staff on Motion to Join as Parties filed
September 8, 1980	Data Presented to be placed in the Official File
September 8, 1980	Official Exhibits filed
September 12, 1980	Order denying motion to modify undertaking
September 16, 1980	Brief of Intervenors and Attorney General filed
September 16, 1980	Intervenor's supplemental brief, in lieu of Oral Argument, that Alcoa and Tapoco be made parties filed
September 16, 1980	List of Exhibits offered during the original hearing which the Attorney General's Office wishes full Commission consideration on motion to join Alcoa and Tapoco as parties filed

Date	Proceedings
September 16, 1980	List and Copy of Certain original hearing exhibits referred to by intervenors filed
September 16, 1980	Letter to Chairman from Aluminum Co. of America and Tapoco, Inc. filed
September 22, 1980	Undertaking to refund filed by Nantahala
September 24, 1980	Additional Brief on Behalf of Tapoco, Inc. filed
September 24, 1980	Additional Brief on Behalf of Aluminum Co. of America filed
September 24, 1980	Motion of Nantahala Power and Light for Extension of Time to Answer Data Request and to Prefile Testimony and Exhibits filed
September 25, 1980	Letter from Attorney General's office in response to letter filed September 19, 1980 filed
September 25, 1980	Tapoco, Inc.'s Response to July 29, 1980 Data Request filed
September 26, 1980	Order Granting Extension of Time and Continuing Hearing
September 29, 1980	Letter from Alcoa to Chairman filed
September 29, 1980	Letter from Public Staff attorney Page in response to Alcoa Letter filed September 29, 1980 filed
October 1, 1980	Statement of Position by Alcoa filed
October 3, 1980	Order issued

Date	Proceedings
October 13, 1980	Order requiring parties Alcoa and Tapoco to comply with data and testimony filings, rescheduling hearing and requiring public notice
October 13, 1980	Letter from Attorney General to Chairman with reasons for request for extension of time filed
October 27, 1980	Joint statement of Exceptions and Motion for Clarification submitted on behalf of Aluminum Company of America and Tapoco, Inc.
November 1[illegible], 1980	Response of Intervenors to Alcoa-Tapoco Motion for Clarification filed
November 14, 1980	Response of Public Staff to exceptions and motion for clarification filed
November 18, 1980	Letter to Public Staff from the Attorney for Town of Bryson City regarding the position of letter dated August 19, 1980 filed
December 15, 1980	Data Request Items I-A through I-D (Filed Pursuant to Commission Order of July 29, 1980)
December 15, 1980	Data Request Item I-E; Volume I—Per Books Present Rates (Filed Pursuant to Commission Order of July 29, 1980)
December 15, 1980	Data Request Item I-E; Volume II—Adjusted Present Rates (Filed Pursuant to Commission Order of July 29, 1980)

Date	Proceedings
December 15, 1980	Data Request Item I-E; Volume III—Adjusted at Allowed Rate of Return (Filed Pursuant to Commission Order of July 29, 1980)
December 15, 1980	Tapoco, Inc.'s Report on Valuation and Depreciation of Electric Plant in Service as of Dec. 31, 1975 (Filed Pursuant to Commission Order of July 29, 1980)
December 15, 1980	Tapoco, Inc.'s Primary Work Paper (Filed Pursuant to Commission Order of July 29, 1980)
December 23, 1980	Order clarifying procedures and affirming filing schedules
January 5, 1981	Letter from Mr. Tucker, Hunton & Williams attorney for Nantahala, commenting on text of order dated December 22, 1980 filed
January 15, 1981	Direct Testimony and Exhibits filed (Volume I: Buchanan, Russell, Vander; Volume II: Leininger, Little, Toof; Volume III: Cockrell, Jontz, Popovich)
January 16, 1981	Petition to Intervene of Cherokee, Graham, Jackson Counties; The Towns of Andrews, Dillsboro, Robbinsville, and Sylva; and The Tribal Council of the Eastern Band of Cherokee Indians, filed
January 16, 1981	All Intervenors' Motion to Expunge Data from the Record filed

Date	Proceedings
February 3, 1981	Nantahala's Response to Petition to Intervene filed
February 5, 1981	Intervenor's Motion to Extend Filing of Pre-Filed Testimony and Exhibits to March 9, 1981 filed
February 6, 1981	Response of Tapoco, Inc. and Alcoa to Intervenor's Motion to Expunge Data from the Record filed
February 9, 1981	Response of Nantahala Power and Light Co. to Expunge Data from the Record filed
February 13, 1981	Intervenor's brief in support of Motion to Expunge Data from the Record filed
February 18, 1981	Order granting extension of time to file testimony
July 27, 1981	Letter from Alcoa regarding extension of due date for Proposed Order filed
July 30, 1981	Order Granting Intervenors' Motion Nunc Pro Tunc to include prefiled testimony of J. Bertram Soloman in the Transcript
August 4, 1981	Volume 17A of transcript mailed
August 5, 1981	Respondent's Proposed Order and Requested Findings of Fact and Conclusions of Law filed
August 5, 1981	Respondent's Initial Brief in Support of Respondent's Proposed Order and Requested Findings of Fact and Conclusions of Law filed

Date	Proceedings
August 5, 1981	Intervenor's Brief of the evidence and arguments of law filed by Attorney General's Office and Public Staff Legal Division
August 6, 1981	Nantahala's Proposed Order Affirming Prior Order and Rejecting Roll-In filed
August 7, 1981	Intervenor's Proposed Findings of Fact, Conclusions and Order filed
August 7, 1981	Motion for Leave to File Three Substituted Pages in the Brief of the Intervenors filed
August 19, 1981	Errata Respondents' Proposed Order and requested findings of Fact and Conclusions of Law and Initial Brief in support filed
August 19, 1981	Nantahala Power and Light Company Errata Sheet filed
September 2, 1981	Order reducing rates and requiring refund
September 2, 1981	News Release by Commission
September 10, 1981	Motions by Nantahala Power and Light Company (1) to extend the time in which exceptions to the panel order of September 2, 1981 and notice of appeal therefrom may be filed and (2) to suspend or delay the effective date of decretal portions of said order filed

Date	Proceedings
September 11, 1981	Response of Intervenors to Motions by Nantahala to extend the time in which exceptions to the panel order of September 2, 1981 and notice of appeal therefrom may be filed and to suspend or delay the effective date of decretal portions of said order filed
September 11, 1981	Exhibit Nantahala Power and Light Company's Case on Appeal with the North Carolina Court of Appeals (Per Memorandum from Commissioner Tate) filed
September 14, 1981	Tapoco and Alcoa's Statement in support of Nantahala's Motion for extension of time in which to file exceptions filed
September 22, 1981	Order allowing extension of time to file exceptions and stay
October 8, 1981	Letter from Nantahala regarding creation of a Negotiation Team filed
October 9, 1981	Letter from Commissioner to Nantahala Power and Light Company regarding Nantahala Negotiations with TVA for replacement of New Fontana Agreement
October 19, 1981	Respondent's Exceptions and Brief; Notice of Appeal; Motion for Reconsideration; and Request for Oral Argument filed
October 19, 1981	Brief of Nantahala in Support of its Exceptions filed

Date	Proceedings
October 19, 1981	Nantahala's Motion to Rescind, Alter, or Amend Order and For Oral Argument and Further Hearings on Exceptions filed
October 19, 1981	Exceptions of Nantahala to Order entered on September 2, 1981 reducing Rates and Requiring Refund. Notice of Appeal therefrom to the North Carolina Court of Appeals filed
October 26, 1981	Intervenors' Initial Response to the Applicant's and Respondents' Exceptions, Notices of Appeal, Briefs on Exceptions and Motions for Oral Argument, Reconsideration and Further Hearing filed
October 27, 1981	Motion to Extend Time for Settling and Filing Record on Appeal filed
October 28, 1981	Order allowing time to file response and settling exceptions for oral argument
October 30, 1981	Public Staff's Response to Nantahala's Motion to extend time for settling and filing record on appeal filed
November 3, 1981	Answer to Intervenor's Initial response to the applicant's and respondents' exceptions, Notices of Appeal, Briefs on Exception and motions for Oral Argument, Reconsideration and Further Hearing filed

Date	Proceedings
November 4, 1981	Order granting extension of time to file proposed record on appeal
November 30, 1981	Intervenors' Joint Brief in Opposition to Exceptions filed
December 7, 1981	Respondents' Reply Brief to Intervenors' Joint Brief in Opposition to Exceptions filed
December 10, 1981	Letter from Alcoa regarding removal of Reamy Ancarrow from the list of [counsel] appearing on behalf of Alcoa and Tapoco, Inc. filed
December 16, 1981	Order Accepting Reply Brief for Consideration and Allowing Time to File Proposed Findings filed
December 23, 1981	Exceptions of Nantahala Power and Light Co. to Portions of Order of Panel Issued December 16, 1981
December 30, 1981	Respondents' Exceptions to Order of December 16, 1981 filed
January 15, 1982	Response of Nantahala to Order of Commission of December 16, 1981, Authorizing Filing of "Comments or Memoranda or Proposed Findings, with Respect to the Federal Questions" raised in this Docket filed
January 15, 1982	Intervenors' Proposed Order Entitled: Final Order Overruling Exceptions and Giving Supplementary Conclusions filed
January 20, 1982	Transcript of oral argument mailed

Date	Proceedings
January 20, 1982	Respondents' Motion to Reject Intervenors' Proposed Order and for Extension of Time filed
January 28, 1982	Final Order Overruling Exceptions and Giving Supplementary Conclusions
February 3, 1982	Motion of Nantahala for Stay of January 28, 1982 Order filed
February 17, 1982	Order Allowing Stay
February 19, 1982	Order clarifying Order of Stay
March 23, 1982	Respondents' Exceptions to Order of January 28, 1982; Notice of Appeal; and Motion for Reconsideration filed
March 23, 1982	Exceptions of Nantahala Power and Light Company to Order Entered on January 28, 1982; Motion for Rehearing; and Notice of Appeal Therefrom to the North Carolina Court of Appeals filed
March 24, 1982	Nantahala's Rate Schedules filed
March 24, 1982	Nantahala's Proposed Plan for Making Refunds filed
April 2, 1982	Response of Intervenors to Nantahala's Proposed Plan for Making Refunds filed
April 2, 1982	Order Allowing Extension of Time to File Record on Appeal
April 8, 1982	Supplemental Response of Intervenor's to Nantahala's Proposed Plan for Making Refunds filed

Date	Proceedings
April 13, 1982	Response of Alcoa to Intervenors' Motion to Require Alcoa to Join in a Refund Plan with Nantahala filed
April 16, 1982	Motion for Filing and Settling Record on Appeal filed
April 16, 1982	Intervenors' Reply to Response of Alcoa Regarding Nantahala's Refund Plan filed
April 19, 1982	Reply of Alcoa to Intervenors' Response filed on April 8, 1982
April 20, 1982	Answer to Response and Supplemental Response of Intervenors to Nantahala's Proposed Plan for Making Refunds filed
May 4, 1982	Order Rejecting Nantahala's Proposed Refund Plan and Requiring Nantahala and Alcoa to file a Joint Plan
May 5, 1982	Order denying motion for reconsideration and rehearing filed
May 24, 1982	Respondent's Proposed Record on Appeal
June 25, 1982	Intervenors' Notice of Partial Approval of Proposed Record on Appeal With Objections and Amendments filed
July 8, 1982	Letter to Chairman from Nantahala regarding the Record on Appeal filed
August 17, 1982	Errata Order

Date	Proceedings
August 17, 1982	Order Prescribing Joint Refund Plan
August 20, 1982	Exceptions to and Notice of Appeal From Commission's Order of August 17, 1982 filed
August 23, 1982	Notice From Court of Appeals, Order Appointing Referee filed
August 25, 1982	Intervenor's Reply to Response of Alcoa and Tapoco to Intervenor's Motion for a Nunc Pro Tunc Ruling on Admission of Exhibit filed
August 27, 1982	Motion to Stay filed
September 1, 1982	Order Nunc Pro Tunc declaring Intervenor's Exhibit L was admitted into evidence
September 1, 1982	Order Denying Motion for Stay
September 1, 1982	Intervenors' Response to Nantahala's Motion for Stay filed
September 2, 1982	North Carolina Court of Appeals Order filed
September 3, 1982	Alcoa's Motion for Stay filed
September 8, 1982	Report of Referee filed
September 9, 1982	Amended Report of Referee
September 9, 1982	Respondent's Exceptions to Orders of August 17, 1982 and September 1, 1982 and Notice of Appeal filed
September 10, 1982	North Carolina Court of Appeals Order filed
September 10, 1982	Order Denying Motion for Stay

Date	Proceedings
September 13, 1982	Exceptions of Nantahala to Nunc Pro Tunc Order Issued on September 1, 1982 and Notice of Appeal filed
September 13, 1982	Exceptions of Nantahala to Order Denying Motion to Stay and Notice of Appeal
September 15, 1982	North Carolina Court of Appeals Order regarding order of June 8, 1982 filed
September 15, 1982	North Carolina Court of Appeals Order regarding order of August 17, 1982 filed
September 15, 1982	Respondent's Exceptions to Order of September 10, 1982 and Notice of Appeal
September 27, 1982	North Carolina Court of Appeals Order filed
March 3, 1983	North Carolina Court of Appeals Order filed
March 28, 1983	Alcoa's Memorandum in Support of Nantahala Petition for Continuance of Stay filed with the North Carolina Court of Appeals
April 11, 1983	Letter to North Carolina Court of Appeals regarding "Alcoa's Response to Appellees' Renewed Motion for Reconsideration of Stay Order" and Certificate of Service
April 22, 1983	North Carolina Court of Appeals Order filed

Date	Proceedings
May 4, 1983	Letter from Lanier, Deputy Clerk of the North Carolina Court of Appeals regarding having a Certified Copy of Petition in this case prepared and delivered to Clerk of Supreme Court filed
May 9, 1983	Letter from North Carolina Court of Appeals regarding Preparation of Record for North Carolina Supreme Court filed
May 9, 1983	Response to Nantahala's Motion for Amendment to Order filed before the North Carolina Court of Appeals
May 18, 1983	Alcoa's Undertaking to Pay Money filed
May 20, 1983	North Carolina Court of Appeals Order filed
May 20, 1983	North Carolina Supreme Court order denying Petitioner's Writ of Certiorari filed
May 24, 1983	Response of Appellees in Opposition to Acceptance of Alcoa's Undertaking to Pay Money filed
May 27, 1983	Letter from Attorney David Poe regarding Letter from R.L. Holz, Alcoa Authorizing the Undertaking to Pay Money filed with the North Carolina Court of Appeals on May 18, 1983 filed
June 6, 1983	Alcoa's Motion for Leave to Respond and Response of Alcoa to "Response of Appellees in Opposition to Acceptance of Alcoa's Undertaking to Pay Money" filed

Date	Proceedings
June 14, 1983	Order of North Carolina Court of Appeals denying response in opposition to acceptance of Alcoa's undertaking filed
September 23, 1983	Application to Issue Securities and Petition to determine refund responsibility filed
November 14, 1983	Order Granting Authority to Sell Senior Securities and Denying Petition to Determine Refund Responsibility filed
December 22, 1983	Alcoa's Petition for Writ of Supersedeas or Stay Motion for Temporary Stay filed
December 28, 1983	North Carolina Court of Appeals Judgment filed

DOCKET OF THE NORTH CAROLINA COURT OF APPEALS

Date	Proceedings
October 6, 1982	Record filed in the North Carolina Court of Appeals
October 6, 1982	Docket fee paid
November 18, 1982	Motion to file amicus curiae brief
November 22, 1982	Aloca Appellant's Brief, filed with the North Carolina Court of Appeals
November 22, 1982	Nantahala's Brief filed
November 22, 1982	Tapoco's Brief filed
December 2, 1982	Order denying Motion to file amicus curiae brief
December 3, 1982	Motion for extension of time in which to file brief filed

Date	Proceedings
December 6, 1982	Order allowing Motion for extension of time to file brief
January 7, 1983	Intervenors-appellees Motion to Quash Joint Brief filed
January 27, 1983	Order denying motion to quash
July 8, 1983	Motion of Alcoa and Tapoco for extension of time for argument filed
July 11, 1983	Order denying motion to extension of time for argument
August 11, 1983	Motion for Limited Admission to Practice filed
August 15, 1983	Order allowing limited admission to practice
August 24, 1983	Motion to supplement record filed
August 25, 1983	Oral argument before the North Carolina Court of Appeals
September 25, 1983	Motion for remand to North Carolina Utilities Commission filed
October 10, 1983	Order denying motion to remand to North Carolina Utilities Commission
December 6, 1983	Opinion issued by the North Carolina Court of Appeals
December 8, 1983	Order allowing motion to supplement record
December 27, 1983	Record certified
January 18, 1984	Notice of Direct Appeal to the North Carolina Supreme Court filed
January 23, 1984	Record certified to the North Carolina Supreme Court
February 6, 1984	Satisfaction recorded

DOCKET OF THE NORTH CAROLINA SUPREME COURT

Date	Proceedings
April 29, 1983	Petition for Writ of Supersedeas and Stay filed with the North Carolina Supreme Court
May 17, 1983	Order denying writ of supersedeas and stay
December 21, 1983	Petition by Alcoa for Writ of Supersedeas and Temporary Stay filed
December 27, 1983	Petition by Nantahala for Writ of Supersedeas and Temporary Stay filed
December 27, 1983	Order allowing petition for writ of supersedeas and temporary stay
February 9, 1984	Stipulation filed
February 9, 1984	Bond filed by Aluminum Co. of America
January 11, 1984	Alternative PSR
January 19, 1984	Motion to file Amicus Curiae Brief filed
January 20, 1984	Motion for Limited Admission to practice
January 23, 1984	Order allowing motion to file amicus curiae brief
January 23, 1984	Order allowing motion for limited admission to practice
January 23, 1984	Order allowing extension of time to file new brief

Date	Proceedings
January 24, 1984	Motion for extension of time to file new briefs filed
January 26, 1984	Motion for extension of time to file new brief filed
January 26, 1984	Order allowing motion for extension to file new brief
February 22, 1984	Motion for extension of time filed
February 22, 1984	Order allowing motion for extension of time allowed
March 23, 1984	Joint Application of Nantahala, Alcoa and Tapoco for extension of time for oral argument in the North Carolina Supreme Court filed
April 9, 1984	Oral Argument before the North Carolina Supreme Court
May 2, 1984	Order denying extension of time for oral argument
July 3, 1985	Opinion of the North Carolina Supreme Court

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA ex rel.
UTILITIES COMMISSION; LACY H.
THORNBURG, Attorney General,
et al.,

Appellees.

On Appeal from the Supreme Court
of North Carolina

APPELLANTS' BRIEF

REX E. LEE*
DAVID W. CARPENTER
SIDLEY & AUSTIN
1722 Eye St., N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Appellants

Of Counsel:
RONALD D. JONES
DAVID R. POE
M. REAMY ANCARROW
LEBOEUF, LAMB, LEIBY
& MACRAE

EDWARD S. FINLEY, JR.
WILLIAM D. JOHNSON
GRADY L. SHIELDS
HUNTON & WILLIAMS

Counsel of Record

QUESTIONS PRESENTED

Under the Federal Power Act, the Federal Energy Regulatory Commission ("FERC") has exclusive jurisdiction to regulate wholesale electric rates and to allocate wholesale power supplies and their costs among different States. This case presents two closely-related questions involving the power of state regulatory commissions to nullify FERC's regulation and otherwise to burden the transmission and wholesale sale of electric power across state lines:

1. Whether the Federal Power Act permits a state regulatory commission, in setting retail rates within the state's borders, to reject the interstate wholesale cost and power allocations that FERC regulates and, in this case, actually approved?

2. Whether the Commerce Clause permits a state regulatory commission to give its citizens a "first call" preference on the inexpensive hydroelectric power generated in a multistate area?

PARTIES BELOW

The appellants in the North Carolina Supreme Court were Nantahala Power and Light Company, Tapoco, Inc., and Aluminum Company of America.

The appellees were State of North Carolina *ex rel.* Utilities Commission: Lacy H. Thornburg, Attorney General; Public Staff of the North Carolina Utilities Commission; Henry J. Truett; Town of Bryson City; Swain County Board of County Commissioners; Cherokee County; Graham County; Jackson County; Town of Andrews; Town of Dillsboro; Town of Robbinsville; Town of Sylva; Tribal Council of the Eastern Band of Cherokee Indians; Muriel Maney; and Derol Crisp.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Cases

Cases

Cases

Administrative Decisions

Statutes

Other Authorities

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA ex rel. UTILITIES COMMISSION; LACY H. THORNBURG, Attorney General, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

APPELLANTS' BRIEF[1]

OPINIONS BELOW

The opinion and judgment of the North Carolina Supreme Court is reproduced in the Appendix to the Jurisdictional Statement ("App.") (1a–138a) and is reported at 313 N.C. 614 and 332 S.E.2d 397. The opinion of the North Carolina Court of Appeals (App. 141a–164a) is reported at 65 N.C. App. 198 and 309 S.E.2d 473. The opinions of the North Carolina Utilities Commission, dated September 2, 1981 (App. 165a–235a), and January 28, 1982 (App. 236a–247a) are unreported. In addition, the pertinent portions of the following decisions of FERC that were issued in a parallel proceeding are reproduced in the Appendix to

[1]The Statement of Appellants Required by Rule 28.1 appears at p. ii of the Jurisdictional Statement.

the Jurisdictional Statement: the FERC decision asserting jurisdiction over the allocation contract (App. 262a–266a), which is reported at 13 FERC ¶ 61,192 (CCH); the FERC Administrative Law Judge decision (App. 267a–282a), which is reported at 15 FERC ¶ 63,014 (CCH); FERC Opinion No. 139 (App. 283a–301a), which is reported at 19 FERC ¶ 61,152 (CCH); and FERC Opinion No. 139-A (App. 302a–313a), which is reported at 20 FERC ¶ 61,430 (CCH).

JURISDICTION

The final judgment of the North Carolina Supreme Court was entered on July 3, 1985. Nantahala's Notice of Appeal (App. 315a–316a) and Alcoa's Notice of Appeal (App 317a) were each filed in the Supreme Court of North Carolina on July 23, 1985. Tapoco's Notice of Appeal (App. 318a) was filed on September 23, 1985. This Court has jurisdiction under 28 U.S.C. § 1257(2). Probable jurisdiction was noted on December 9, 1985.

CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution, Article VI, Clause 2: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land. . . ."

The United States Constitution, Article I, Section 8, Clause 3: "The Congress shall have Power . . . [t]o regulate Commerce . . . among the several States. . . ."

The pertinent provisions of the Federal Power Act, 16 U.S.C. §§ 791a–828c, and of the North Carolina Public Utilities Act, N.C. Gen. Stat. §§ 62-1, *et seq.*, are reproduced in the Appendix to the Jurisdictional Statement (App. 248a–261a). In addition, the terms of Section 313 of the Federal Power Act (16 U.S.C. § 825*l*(b)) appear in the Appendix to this Brief.

STATEMENT OF THE CASE

Introduction

Under the Federal Power Act, the Federal Energy Regulatory Commission ("FERC") has the exclusive jurisdiction to regulate the transmission and wholesale sale of electricity in interstate commerce. This case presents the question whether a State may use its separate authority over retail rates to nullify this FERC regulation and give that state's citizens a "first call" preference to the hydroelectric power generated in a multi-state area.

As FERC has stated, the issue arises in the context of a "classic dispute" between two States over how a pool of low-cost power is to be allocated between them.[2] Nantahala Power and Light Company (Nantahala) is a subsidiary of Aluminum Company of America (Alcoa) that sells electricity to retail customers and three wholesale customers in western North Carolina. Tapoco, Inc. (Tapoco) is an Alcoa subsidiary that sells electricity to an Alcoa aluminum plant in eastern Tennessee exclusively. Each utility and each set of customers have two power sources—low-cost TVA "entitlements" power and expensive TVA purchased power. Each State and each set of customers would prefer to have as much as possible of the low-cost entitlements power, and as little as possible of the high-cost purchased power. Because FERC's rate schedules determine how the power supplies and costs are allocated between these States, Nantahala's customers instituted proceedings before FERC in which they unsuccessfully contended that FERC should modify the pertinent rate schedules to give North Carolina far more of the low-cost power. The North Carolina Attorney General represented Nantahala's retail customers throughout these extensive proceedings.

[2] Brief for the United States and the Federal Energy Regulatory Commission As Amici Curiae In Support of Jurisdictional Statement (October, 1985), p. 9.

However, North Carolina has refused to give effect to the FERC rate schedules and decisions in setting Nantahala's retail rates. Instead, it used its retail ratemaking powers to "effectively allocate" greater costs to Tennessee (App. 69a–70a) and impose the very preferential cost and power allocations that FERC's regulation had rejected.

1. **Background: The New Fontana Agreement And 1971 Apportionment Agreement.** Nantahala, Tapoco, and the Tennessee Valley Authority (TVA) are each engaged in the generation of hydroelectric power on the Little Tennessee River and its tributaries. Pursuant to its statutory authority to develop and control this watershed, TVA owns and operates the Fontana dam in North Carolina, which is the largest hydroelectric generating facility in the eastern half of the United States. Nantahala owns a number of plants in North Carolina, which are upstream from TVA's Fontana dam. Tapoco owns two plants in Tennessee and two plants in North Carolina, which are downstream from the Fontana dam.[3]

In 1962, TVA, Nantahala, Tapoco, and Alcoa entered into a power coordination and exchange agreement, which has been called the New Fontana Agreement (sometimes referred to as "NFA").[4] App. 14a–15a, 28a–29a. Under this agreement, TVA both controls the generation of power at Nantahala's and Tapoco's facilities and receives all the electricity that is generated. In return, TVA provides Nantahala and Tapoco collectively with fixed entitlements to electric power. These consist of both "capacity entitlements" in megawatts ("mW")[5] and "energy entitlements" in megawatt-hours ("mWh").[6] See App. 14a–15a, 28a–29a, 216a. Because Nantahala and Tapoco are exchanging their actual generation, which varies substantially with stream flow, for more consistently available TVA power, the TVA entitlements are less than Nantahala's and Tapoco's actual generation of electricity in most years. The energy and capacity that TVA retains under the NFA is essentially a "bankers' fee," which compensates TVA for the obligations and risks that it assumed.[7]

In 1971, Nantahala and Tapoco entered into the 1971 Apportionment Agreement. It prescribes how the TVA entitlement power is divided between the two utilities and the two States.[8] This agreement assigned Nantahala 54.3 mW in capacity entitlements and 360 thousand mWh in energy entitlements annually for use in serving its North Carolina customers. Tapoco is assigned the remaining NFA energy and capacity entitlements to serve its Tennessee customer.

The New Fontana Agreement and 1971 Apportionment Agreement are interstate wholesale power exchange agreements subject to FERC's jurisdiction under Part II of the Federal Power

[3] Tapoco has a license under Part I of the Federal Power Act that expressly authorizes it to operate these plants to supply power to the Alcoa aluminum plant in Alcoa, Tennessee. App. 272a–273a.

[4] The NFA superseded the Original Fontana Agreement (OFA), which was in effect between 1941 and 1962.

[5] Capacity entitlements determine the amounts of energy that Nantahala and Tapoco/Alcoa may demand at any one time, without incurring the costs of supplemental high-cost power from TVA. Thus, the companies incur far greater costs per megawatt for the difference between (1) their peak demands (the particular hour and day when their consumptions are the highest) and (2) their lower capacity entitlements. See App. 28a, 31a.

[6] Energy entitlements determine the total amounts of energy that the two firms may obtain annually from TVA under the contracts. See App. 28a, 31a. To the extent that these amounts are exceeded, the firms incur the costs of supplemental high-cost TVA purchased power.

[7] Under the NFA, TVA has an obligation to provide constant and levelized amounts of power, regardless of differences between the timing of the generation of electricity at each of the utilities' facilities and the demand of the utilities. With its huge electrical system, TVA is able to act as a banker and provide Nantahala and Tapoco with entitlement power at times when the generation by their own facilities is insufficient because of steam flow variations.

[8] Prior to 1971, Alcoa also purchased power from Nantahala, under a 1963 agreement that effectively defined Nantahala's share of the entitlements. App. 30a.

Act. See App. 262a–266a; see also App. 72a.[9] FERC has denominated the New Fontana and 1971 Apportionment Agreements as Nantahala's FERC Wholesale Rate Schedule No. 1.[10] App. 72a.

Between 1962 and 1971, Nantahala's entitlements were sufficient to serve all the needs of Nantahala's public customers. App. 30a. However, the demand for electricity in western North Carolina has steadily increased, and in 1971, Nantahala began to purchase additional, more expensive power from TVA. By 1975, this additional expensive power cost 18.5 mils per kWh (see App. 32a)—or more than three times the cost per kWh of the entitle-

[9]The North Carolina Supreme Court's opinion correctly states that there were questions involving the applicability of particular provisions of the Federal Power Act to Tapoco and Nantahala during the period between 1930 and the early 1960s. App. 18a–26a, 29a. These disputes are irrelevant to this case. They pertained to whether the Little Tennessee River or specific tributaries are "navigable," within the meaning of Part I of the Act (16 U.S.C. §§ 791a–823a) (App. 18a–26a) and whether, *prior* to this Court's decision in *FPC* v. *Southern California Edison Co.*, 376 U.S. 205 (1964), the OFA and the NFA (each of which was filed at the Commission) had sufficient impact on interstate commerce to be regulated as a rate schedule under Part II of the Act (16 U.S.C. §§ 824–828c.) (App. 29a).

Similarly, while there was also a subsequent dispute over the federal regulation of the 1971 Apportionment Agreement (see App. 31a), it was purely technical. It involved *how* the agreement would be regulated, not *whether* it would be regulated under the Federal Power Act. For example, while the 1971 Allocation was not technically filed as a Section 205 rate schedule until 1980, FERC made the filing of the agreement as a rate schedule effective retroactive to 1971. This reflected that the agreement had been on file with the Commission, and had been the basis for FERC's regulation, since the early 1970s. Tr. Vol. 7, pp. 44–45. See also Brief of Federal Energy Regulatory Commission, *Nantahala Power & Light Co.* v. *FERC*, Nos. 82-1872(L), 82-1896, 82-2032, 82-2131, 82-1904, & 82-1948 (4th Cir.) (filed April 1, 1983), p. 19.

[10]These are also denominated Tapoco FERC Wholesale Rate Schedule No. 3. App. 72a, 263a.

ment power (which is less than 6 mils per kWh). See Ex. RDB-R2; Tr. Vol. 3, p. 3.[11]

In 1976, Nantahala sought to increase its rates. It filed a request with FERC to increase its charges to its three wholesale customers and a separate request with the North Carolina Utilities Commission to increase its charges to its retail customers. App. 7a, 269a. A common fact underlying each of these proceedings is that Nantahala's costs of obtaining power for resale to both sets of customers are determined by the FERC-regulated New Fontana and 1971 Apportionment Agreements. Nantahala's wholesale and retail customers both sought to avoid rate increases, and obtain refunds, by asserting claims that these agreements were unfair. Each group of customers contended that the agreements should be modified or disregarded and that greater amounts of inexpensive entitlements power should be allocated to North Carolina. This led to a formal FERC investigation of the fairness and reasonableness of these agreements to Nantahala and its customers under Section 206 of the Federal Power Act.

2. **The FERC Investigation Of The Agreements Under Section 206.** This investigation was instituted by Nantahala's wholesale customers in 1978 when they filed a formal complaint with FERC against Alcoa, Tapoco, and Nantahala and sought relief under Section 206 of the Federal Power Act. See App. 256a–257a. The North Carolina Attorney General intervened in this FERC complaint proceeding on behalf of the "using and consuming public in North Carolina."[12]

[11]Nantahala bears its own costs of generation under the NFA. Thus, the unit cost of the entitlement power is determined by dividing Nantahala's costs of operating its generating facilities by the volume of the entitlement power allocated to Nantahala. In contrast, Nantahala pays for the power purchased from TVA.

[12]Tr. 163, FERC Dockets EL78-18 & ER76-828. The complaint proceeding was consolidated with Nantahala's separate 1976 request for an increase in the rates to its three wholesale customers. See *supra*.

Nantahala's retail and wholesale customers contended that Alcoa had manipulated the terms of the New Fontana Agreement and 1971 Apportionment Agreement to benefit Alcoa's aluminum production operations in Tennessee at the expense of Nantahala's North Carolina customers. After a five-week evidentiary hearing before an Administrative Law Judge in which all the transactions among affiliates were carefully scrutinized (App. 267a–282a), FERC considered and rejected most of the North Carolina customers' claims under Section 206 of the Act.

FERC rejected the claims that the New Fontana Agreement was unfair to Nantahala and had improperly traded off the needs of Nantahala's wholesale and retail customers in North Carolina to benefit Alcoa's plant in Alcoa, Tennessee. App. 293a–295a. FERC found that there was "no intent [in the New Fontana Agreement] to ignore the needs of Nantahala's public service customers or deprive them of energy at just and reasonable rates." App. 295a. It thus treated this agreement as establishing the entitlements to inexpensive power that Nantahala and Tapoco could divide. FERC also specifically rejected the claims that Alcoa "used the separate corporate identities of Nantahala and Tapoco to frustrate the purposes of the Federal Power Act" and that the North Carolina and Tennessee entities should be "rolled-in" and regulated as a single integrated system. App. 291a.

FERC then turned to the 1971 Apportionment Agreement. It approved the allocation of 54.3 mW of capacity entitlements to Nantahala, finding it to be fair and reasonable. App. 297a. However, FERC concluded that the record did not support the fairness of the 1971 Apportionment Agreement's allocation of 360 thousand mWh of energy entitlements to Nantahala, and FERC then decided how much greater that share would be, increasing this allocation to 404 thousand mWh. App. 298a. In its final order in this complaint and rate proceeding, FERC affirmed the Administrative Law Judge's determination that the "just and reasonable rates and

charges are those which are in conformity with the findings and conclusions set forth in [its] decision." App. 282a; see App. 301a.

Both Nantahala's retail customers, again represented by the North Carolina Attorney General, and Nantahala's wholesale customers appealed these FERC determinations to the United States Court of Appeals for the Fourth Circuit. Nantahala also appealed FERC's order. The Fourth Circuit affirmed FERC's order in its entirety. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984).

3. **The North Carolina Retail Rate Proceedings.** In the retail rate case that had been filed in 1976, the North Carolina Utilities Commission ("NCUC") set Nantahala's retail rates by determining its overall retail revenue requirements in the 1975 test year. In its initial decision in 1977, the NCUC had agreed that the FERC-regulated rate schedules and power supply agreements determined one aspect of these retail revenue requirements—Nantahala's reasonable costs of obtaining power for resale to its retail customers—and the NCUC approved the retail rate increase.[11] However, in 1980, the North Carolina Supreme Court reversed this decision. It held that Nantahala's public customers should "have in effect, [a] 'first claim' on all energy actually generated by Nantahala's facilities" and remanded Nantahala's rate case to the NCUC to consider whether the FERC-regulated contractual arrangements are "in the best interests of the customers of Nantahala." *North Carolina ex rel. Utilities Commission* v. *Edmisten*, 299 N.C. 432, 434, 438, 263 S.E.2d 583, 586, 588 (1980).

On remand, in 1981, the NCUC proceeded to make its own determinations of the very interstate cost and power allocation

[11]Indeed, the NCUC had previously found the New Fontana Agreement and the 1971 Apportionment Agreement to be "reasonable," and the North Carolina Supreme Court had accepted that finding in an earlier appeal. *North Carolina ex rel. Utils. Comm'n* v. *Edmisten*, 291 N.C. 575, 232 S.E.2d 177, 179 (1977).

issues that were then being litigated before FERC. This meant that the fairness of the NFA and the 1971 Apportionment Agreements were being simultaneously investigated by two agencies: FERC, which has jurisdiction to consider the issue, and the NCUC, which does not.[14]

The NCUC's decision was issued in September 1981, and reaffirmed in January 1982. App. 165a–247a. In setting the retail rates, the NCUC refused either to give effect to the Nantahala FERC rate schedules, as filed, or to make provisions in the retail rate orders for FERC's ultimate determinations in the then-pending complaint proceeding under Section 206 of the Federal Power Act.[15] Instead, the NCUC set rates on the basis of a radically different interstate costs allocation, which assigned Nantahala far more of the low-cost power than had FERC's regulation.

The NCUC achieved these greater allocations by going beyond the North Carolina Supreme Court's earlier mandate that North

[14]Alcoa and Tapoco filed suit in federal district court on January 25, 1982 (prior to the final NCUC decision) seeking to enjoin threatened NCUC action on the ground that it interfered with the operation of the Federal Power Act and impermissibly burdened interstate commerce. The District Court and Fourth Circuit held that abstention principles precluded the District Court from adjudicating these claims and did not address the merits of the preemption or Commerce Clause issues. See *Aluminum Company of American* v. *Utilities Comm'n*, 713 F.2d 1024, 1028-30 (4th Cir. 1983). This Court denied Alcoa's petition for certiorari with Justices Brennan and White noting that they would have granted the petition. 104 S. Ct. 1326 (1984).

[15]At the time of the NCUC's final decision in January, 1982, the FERC Administrative Law Judge's decision had been issued, but it was not affirmed by FERC until May, 1982.

In this circumstance, a state utility commission can protect all legitimate ratepayer interests by permitting retail rates to go into effect on the assumption that the FERC rate schedule is reasonable, but requiring the utility "to reimburse the individual consumers for any . . . costs which may be disallowed" as a result of a future ruling by FERC. See *Narragansett Elec. Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358, 1363 (1977), *cert. denied*, 435 U.S. 972 (1978).

Carolina be given a "first claim" on all the hydroelectric energy generated in North Carolina by Nantahala. Instead, the NCUC, in its words, gave "North Carolina's public load" a "first call" preference to the "total electric energy output of the combined [Nantahala-Tapoco] system," thus applying North Carolina customers' preference to low-cost power generated by Tapoco in Tennessee and North Carolina as well as to Nantahala's North Carolina generation. App. 183a; see *id.* 240a. As the intervenor witness who sponsored the NCUC's methodology testified, under the projections for the growth in Nantahala's demand, the NCUC's methodology would mean that there would be no low-cost hydroelectric power left for Tennessee within eight years. Tr. Vol. 7, pp. 38–39.

The NCUC determined Nantahala's costs of power by developing an assumed pool of power supply costs and multiplying it by an allocation factor, the product of which nominally represented Nantahala's share of that pool of costs. The preference for North Carolina results from three interrelated aspects of the NCUC's methodology, *each* of which is inconsistent with FERC's explicit findings and regulation.

First, contrary to FERC's jurisdictional determination that Nantahala and Tapoco are not a single entity (App. 262a–266a, 291a),[16] the NCUC nonetheless developed the assumed pool of

[16]FERC's jurisdiction over the 1971 Apportionment Agreement, and the arrangements under which the TVA entitlements are allocated between North Carolina and Tennessee, depended on the existence of separate wholesale exchanges of bulk power supplies between TVA and Nantahala on the one hand and between TVA and Tapoco on the other. If Nantahala and Tapoco were regulated as a single entity, FERC would have had jurisdiction only over the NFA and not over the 1971 Apportionment Agreement. See also p. 33 n. 46, *infra*.

Thus, when FERC initially accepted the 1971 Apportionment Agreement for filing as part of the Nantahala Rate Schedule No. 1 in 1980, Nantahala's retail and wholesale customers urged, and FERC agreed, to make this jurisdictional determination subject to FERC's ultimate finding in the then-pending complaint proceeding on whether

(Footnote continued on next page)

costs by combining or "rolling-in," the two companies' costs and power supplies into a hypothetical "Alcoa power system." However, the hypothetical system costs that the NCUC created included only the low-cost power of Nantahala and Tapoco and Nantahala's purchases of high-cost TVA power. By excluding Tennessee's (*i.e.*, Alcoa's) purchases of high-cost power, the NCUC assured that greater amounts of low-cost power would be allocated to North Carolina.[17] Concomitantly, by making Tennessee's high-cost power its *sole* responsibility and dividing North Carolina's high-cost power between the two States, the NCUC assured that 75% of the high-cost North Carolina power would be paid for by Tennessee. See App. 219a–220a.

(Footnote continued from previous page)

Tapoco and Nantahala should be "rolled-in." App. 264a–265a; see FERC Docket No. ER81-19-000, Town of Highlands' Protest, Petition To Intervene, Motion for Five Month Suspension Period, Motion To Compel Filing of Supporting Data, And Motion To Toll The Suspension Period Until Supporting Data Is Filed (filed Nov. 12, 1980); *id.*, Petition By The State Of North Carolina To Intervene Out Of Time, Protest, Motion For Five Month Suspension Period, Motion To Compel The Filing Of Supporting Data, And Motion To Toll The Suspension Period Until Supporting Data Is Filed (filed Nov. 25, 1980).

[17]Tapoco, Nantahala, and their respective customers together have four sources of power. Two of them are low-cost and two are not. They are: 1) Nantahala's entitlements from TVA, 2) Tapoco's entitlements from TVA, 3) Nantahala's purchases from TVA, and 4) Alcoa's purchases from TVA delivered to it by Tapoco. The Commission "rolled-in" only the first three. It left out Alcoa's expensive purchases from TVA (App. 211a; see App. 66a) and thereby assured that North Carolina's share of the low-cost power would be inflated.

The NCUC acknowledged that Alcoa's TVA purchases were excluded because they were so large as to "warp and twist" its allocation methodology. App. 215a. In fact, Alcoa's average cost of power from low-cost hydroelectric power and expensive TVA purchases is higher than Nantahala's. See Tr. Vol. 14, p. 70. Thus, if Alcoa's TVA purchases were included in the roll-in, the costs allocated to North Carolina would have exceeded Nantahala's costs under the NFA and the 1971 Apportionment Agreement. See App. 66a.

Second, contrary to FERC's determination that Nantahala's share of the low-cost power should be determined by its percentage of the actual generation turned over to TVA (App. 297a–298a),[18] the NCUC determined North Carolina's percentage share on the basis of Nantahala's customers' total, and ever-increasing needs. Specifically, the NCUC developed Nantahala's allocation factors by taking its peak load and its total annual requirements for energy and dividing them by the combined system's assumed available capacity and energy. This assured that North Carolina's percentage share of the low-cost power will increase, and Tennessee's will decline, whenever North Carolina's needs increase. In fact, North Carolina's needs have increased, and will continue to do so. Thus, when the identical methodology was applied in a subsequent rate case involving a 1979 test year,[19] the intervening increases in Nantahala's need for power resulted in even greater allocations of low-cost power to Nantahala and to North Carolina.

Third, contrary to FERC's determination that the New Fontana Agreement is fair and reasonable to Nantahala (App. 293a–295a), the NCUC found it unlawfully preferred Tapoco/Alcoa's interests to Nantahala's and should be disregarded in determining Nantahala's share of the low-cost power. On this basis, the NCUC determined Nantahala's total share of the low-cost power by applying Nantahala's assumed percentage — and only Nantahala's — not to Nantahala's and Tapoco's actual entitlements under the New Fontana Agreement, but rather to hypothetical larger amounts that include generation

[18]FERC based Nantahala's allocation on the proportion that the average generation of Nantahala's facilities bore to the total average generation of the Nantahala and Tapoco facilities that were turned over to TVA. The factor was applied against the total TVA entitlements under the NFA. App. 297a–298a.

[19]See *North Carolina ex rel. Utilities Commission* v. *Nantahala Power and Light Co.*, 314 N.C. 246, 333 S.E.2d 217 (1985), notice of probable jurisdiction pending, No. 85-1165 (filed January 10, 1986) (applying same methodology to 1979 test year).

that TVA retained as a "bankers' fee" and was therefore never available to Nantahala or Tapoco. See p. 5 & n. 7, *supra*.[20] Because Tennessee receives only what is left, the sole beneficiary of the NCUC's paper increase in the amount of low-cost power is North Carolina.

The following chart shows NCUC's energy and capacity allocations, and how they give Nantahala radically more of the low-cost power than has FERC's regulation:

	Nantahala's Capacity Allocation	Nantahala's Energy Allocation
FERC Nantahala Rate Schedule No. 1 as filed .	54.3 mW	360 thousand mWh
As Adjusted by FERC Decisions	54.3 mW	404 thousand mWh
NCUC Allocation for 1975 Test Year	92.7 mW[21]	433 thousand mWh[22]
NCUC Allocation for 1979 Test Year	100.1 mW[23]	460 thousand mWh[24]

As the North Carolina Supreme Court stated, the "practical effect" of the NCUC Order in the 1976 rate case is that Nantahala was barred from recovering all of the wholesale costs "associated with" the FERC-regulated NFA and 1971 Apportionment Agreement. See App. 69a. Indeed, in this case, the NCUC's decision to refuse to give effect to the cost and power allocations

[20]For example, the NCUC assumed that Nantahala and Tapoco had a total of 376.9 mW of inexpensive hydroelectric capacity (App. 219a), which is greatly in excess of the 218.3 mW in capacity entitlements provided by TVA under the NFA.

[21]92.7 mW is 24.6% of the 376.9 mW of the assumed hydroelectric capacity allocated to Nantahala in the 1975 test year. App. 219a-220a.

[22]433 thousand mWh is 24.51% of the 1,765,100 mWh of assumed hydroelectric energy allocated to Nantahala. App. 220a-221a.

[23]See p. 13 n. 19, *supra* & Appendix to Jurisdictional Statement in No. 85-1165, p. 70a (26.56% times 376.9 mW).

[24]See p. 13 n. 19, *supra* & Appendix to Jurisdictional Statement in No. 85-1165, p. 71a (26.06% times 1,765,100 mWh).

contained in the FERC rate schedules led to the *direct* exclusion of $2 million of the wholesale costs that Nantahala incurred as a result of the FERC rate schedules from Nantahala's retail revenue requirements in the 1975 test year, reducing these revenue requirements from $11 million to $9 million. App. 234a. This reduction, in turn, led the NCUC to order refunds to Nantahala's customers of $19 million[25] ($29 million with interest) — and a subsequent rate case has increased the refund obligation to $45 million.[26] As the North Carolina Supreme Court acknowledged, these reductions in Nantahala's allowable costs and revenue requirements "effectively allocated" additional costs to Tapoco and to Tennessee. App. 69a-70a.

The NCUC formalized this reallocation of costs by ordering Tapoco's Tennessee customer (Alcoa) to make the "refund" to the North Carolina customers. It reasoned that the $19 million refund in the instant case exceeds Nantahala's net worth and that it is therefore necessary that Alcoa,[27] whose Tennessee "manufacturing load" (App. 244a) was found to be the beneficiary of the NFA and 1971 Apportionment Agreements, fund the refunds to the extent that Nantahala may not do so without impairing its capital. App. 178a-179a.

[25]See NCUC Order Rejecting Nantahala's Proposed Refund Plan And Requiring Nantahala And Alcoa To File Joint Plan (May 4, 1982).

[26]See *North Carolina ex rel. Utilities Commission* v. *Nantahala Power and Light Co.*, 314 N.C. 246, 333 S.E.2d 217 (1985), jurisdictional statement pending, No. 85-1165 (filed January 10, 1986). Indeed, it appears that the North Carolina Supreme Court intends to require the continuing subsidization of North Carolina customers. See *North Carolina ex rel. Utilities Commission* v. *Edmisten*, 314 N.C. 122, 333 S.E.2d 453 (1985). Appellants will seek review in this latter case in a filing to be made with this Court on or before February 3, 1986.

[27]Alcoa was involuntarily made a party to these NCUC proceedings in 1980, after the case was remanded to it by the North Carolina Supreme Court, on the theory that Alcoa is a North Carolina "public utilit[y]" and part of the hypothetical Alcoa system. App. 9a, 232a. No serious attempt was made to square this finding with the exclusion of Alcoa's purchased power from the hypothetical rolled-in system. See p. 12 & n. 17, *supra*.

The North Carolina Supreme Court affirmed the NCUC order in a 132-page opinion. It held that the Federal Power Act permitted the NCUC "to do exactly what [it] has done in the instant case": make its own investigations of the appropriate interstate power arrangements and exclude from retail rates any costs that it finds were not reasonably incurred to benefit ratepayers in that State, but were assignable to customers in other States.[28] App. 84a; see *id.* 69a–70a. The North Carolina Supreme Court further held that the NCUC order was even-handed regulation with only an incidental effect on interstate commerce, and did not violate the Commerce Clause. App. 100a–106a.

SUMMARY OF ARGUMENT

This case presents the question of who is to have the effective authority to decide how the interstate wholesale costs of producing and transmitting electricity should be allocated between customers in different States: FERC, in the exercise of its explicit statutory authority to regulate these arrangements, or each of the affected States, in the exercise of their separate retail ratemaking responsibilities. Both the Federal Power Act and the Commerce Clause foreclose North Carolina's position.

1. The terms and purposes of the Federal Power Act make it very clear that state commissions must give effect to FERC's regulation in setting retail rates and are required to do what the NCUC refused to do here: include in the utility's North Carolina retail revenue requirements and retail rates all the costs that the local utility incurs as a result of FERC rate schedules and decisions. If the state commission believes that these rate schedules assign costs to its ratepayers that were not reasonably incurred

[28]The North Carolina Supreme Court's specific holding was that a North Carolina statute (N.C. Gen. Stat. § 62-133, App. 258a–261a) required this action and that this application of the statute was not preempted by the Federal Power Act. See App. 78a. For simplicity's sake, this Brief will use the phrase "North Carolina's actions," to refer to the statute, the rate order, and the judicial decisions upholding them.

for their benefit, the state commission's *exclusive* remedy is to exercise its explicit statutory right to file a complaint with FERC and seek modifications to these rate schedules. It may not simply exclude those costs from the utility's retail revenue requirements—as North Carolina did here. Any other rule would thoroughly subvert the operation of the uniform, orderly, and equitable scheme that Congress created.

This Court's prior decisions squarely reject North Carolina's position that, while States may not modify FERC rate schedules directly, they may act in ways that indirectly achieve the same result. For example, in ***Maryland* v. *Louisiana***, 451 U.S. 725, 749-50 (1981), the Court held that States are preempted from taking any action that has the "effect" of reallocating "the incidence" of costs between customers and "interfer[ing] with the FERC's authority to regulate the determination of the proper allocation of costs . . . ." That is what North Carolina did here.

More pertinent still are this Court's decisions requiring States to give effect to FERC rate schedules and preempting the application of any state laws that would have the "effect" of authorizing commerce on terms other than the rate on file with FERC. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 578-80 (1981); *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951). This "filed rate doctrine" requires state utility commissions to include in a local utility's retail rates all the costs incurred under FERC rate schedules. If a state commission believes that some of these costs may not have been reasonably incurred to benefit ratepayers in that State, its sole remedy is to condition a rate increase on the provision of a refund to the extent FERC thereafter orders a wholesale rate reduction in a properly-instituted FERC proceeding.

State supreme courts have uniformly agreed. They hold that state commissions have no jurisdiction to investigate the interstate cost allocations and rate determinations that are subject to

FERC's jurisdiction. Whatever method a state commission adopts in setting retail rates, it must include all costs incurred under FERC rate schedules and decisions in retail revenue requirements and treat these costs as reasonable operating expenses. *E.g.*, *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978). These principles apply with the greatest force where, as here, FERC's regulation has resolved disputes between different States over the allocation of interstate wholesale costs among them. See, *e.g.*, *Northern States Power Co.* v. *Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn.), *cert. denied*, 104 S. Ct. 3546 (1984); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981).

These decisions are clearly correct. A contrary rule would defeat the central purpose of the Federal Power Act by allowing States to burden commerce by separately pursuing "their respective local interests" at the expense of neighboring States. See *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83, 89-90 (1927). Litigation of these issues in each affected State would also wholly "defeat[ ] . . . the federal objective of providing orderly and streamlined procedures for approval of wholesale transactions," *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696, 702 (N.H. 1985), and lead to the very "case-by-case" analysis of state action under the Commerce Clause that the Federal Power Act sought to avoid. *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 380 (1983); *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 214-16 (1964).

2. Even if North Carolina's actions were not preempted by the Federal Power Act, they violate the Commerce Clause. An analysis of the purpose and effect of North Carolina's actions demonstrates that there is no legitimate local interest that can justify North Carolina's attempts to adopt, for retail ratemaking purposes, different allocations of the interstate wholesale costs than are contained in the pertinent FERC rate schedules and decisions.

North Carolina's actions epitomize the severe interference with national commerce that it was the purpose of the Commerce Clause to prevent. Foremost, North Carolina's orders constitute blatant economic protectionism. Their purpose and effect were to give North Carolina citizens a "first call" preference to the economic benefits of a scarce resource: the low-cost hydroelectric power generated in a multi-state region. Under the NCUC's methodology, North Carolina customers will have the exclusive benefits to the low-cost power generated by Nantahala and Tapoco in North Carolina and Tennessee within eight years. This Court's decisions establish that such preferences are virtually invalid *per se*. *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982).

Further, North Carolina is regulating an area of commerce in which the national interest is overwhelming: interstate wholesale sales and exchanges of power. See *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, *supra*, 461 U.S. at 377. It is beyond question that the effects of North Carolina's actions on this commerce are substantial — the interstate allocation of $45 million in costs is at issue — and North Carolina is regulating extraterritorially by imposing those costs on a manufacturing plant in eastern Tennessee. See *Edgar* v. *MITE Corp.*, 457 U.S. 624, 642 (1982).

Conversely, the local interests that North Carolina has advanced are palpably insufficient to justify its regulation. While the protection of local ratepayers from "excessive costs" and "corporate abuses" is a legitimate interest, the overriding fact here is that FERC's regulation provides these "same substantive protections." *Edgar* v. *MITE Corp.*, *supra*, 457 U.S. at 644-45. North Carolina has no legitimate interest in collaterally attacking FERC's findings and imposing "protections" that go beyond FERC's. *Id.*

ARGUMENT

In this case, North Carolina and the Federal Energy Regulatory Commission made very different determinations of how the wholesale costs of generating and transmitting electricity should be allocated between customers in different States. The question presented in this case is not who is right and who is wrong about the underlying facts. Rather, it is who is to have the effective authority to make the determinations: FERC, under its explicit statutory authority to regulate these arrangements, or each of the affected States, under their separate retail ratemaking authority.

The Federal Power Act and the Commerce Clause provide very clear answers to this question. The Commerce Clause, by its own force, prohibits North Carolina actions here. *See* Part II, *infra.* However, Congress's affirmative exercise of its power under the Commerce Clause in the Federal Power Act eliminates any need for such a "case-by-case" analysis of the purpose and effect of North Carolina's actions on interstate commerce.

The Federal Power Act requires state commissions to accept FERC's exclusive jurisdiction over wholesale activities and do what North Carolina refused to do: include all the costs incurred as a result of FERC rate schedules and decisions in a local utility's retail revenue requirements and rates. If a state commission believes that a local utility is incurring costs that do not benefit ratepayers in that State, its *exclusive* remedy is to file a complaint with FERC and participate in the appropriate proceedings—as the North Carolina Attorney General did here. The State may not use its retail ratemaking authority to nullify FERC's jurisdiction. Otherwise, the orderly, equitable, and uniform regulation of interstate electricity transactions that Congress envisioned would be subverted. In its place would be a circumstance reminiscent of that which brought our national government to an end during the Articles of Confederation era: each State free to pursue its individual economic objectives without regard to the effect on other States.

I. North Carolina's Actions Are Preempted By The Federal Power Act.

The Federal Power Act was enacted because Congress, like this Court before it, recognized that the "uncontrolled state regulation" of the "production and transmission of energy" can "patently interfere with broader national interests."[29] Because these activities are "particularly likely to affect more than one State,"[30] state regulation would be an invitation to chaos. The reasonableness of the interstate wholesale transactions could be subject to litigation, and determinations, in multiple state commissions. Because all States would seek to advance "their respective local interests," the likely result would be inconsistent state determinations that would either prevent interstate wholesale producers from recovering all their costs or unfairly shift costs among affected States.[31]

Congress sought to prevent such interference with commerce by vesting the Federal Power Commission (now FERC) with exclusive jurisdiction to regulate the transmission and wholesale sales of electricity in interstate commerce. Congress drew "a bright line easily ascertained" to divide state and federal regulatory authority. *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215–16 (1964). Under this "bright line," States are prohibited from regulating these bulk power supply arrangements among utilities, regardless of the actual "impact of state regulation upon the national economy." *Id.*

At the same time, Congress directed FERC to resolve disputes over the interstate allocations of costs and established an orderly,

[29] *Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983). See *FPC* v. *Southern California Edison Co.*, 376 U.S. 205 (1964); *Public Utils. Comm'n* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).

[30] *Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, *supra*, 461 U.S. at 377.

[31] *Public Utils. Comm'n* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83, 89–90 (1927).

uniform procedure to make these and other wholesale rate determinations. Under Section 205 of the Act, every utility that provides electricity at wholesale in interstate commerce must file rate schedules showing all rates and charges, all classifications, practices, and regulations affecting such rates and charges, and all contracts affecting those rates and charges. 16 U.S.C. § 824d; App. 253a–256a. FERC is required to assure that these schedules are "just and reasonable." *Id.*

Because wholesale rates become costs for purposes of the retail rates that States regulate, the Act further gives a significant role to States and state commissions. "Any person, State, municipality, or State Commission" may file complaints with FERC seeking modifications in the rate schedules under Section 206 of the Act and may obtain judicial review of FERC decisions in federal courts of appeals. Federal Power Act, § § 206, 306, 313; 16 U.S.C. § § 824e(a), 825e, 825*l*(b); App. 256a–257a; Appendix to this Brief. There plainly would have been no need for these provisions if the federal remedies were not exclusive and if FERC's determinations were not intended to bind state commissions in the exercise of their retail ratemaking responsibilities. See *Massachusetts* v. *United States*, 729 F.2d 886, 888 (1st Cir. 1984).

North Carolina has conceded that these provisions prohibit States from directly regulating wholesale transactions in interstate commerce. The North Carolina Supreme Court upheld the NCUC's decision only because it said it was not modifying any contract or rate schedule that is regulated by FERC. App. 105a. However, North Carolina's refusal to allow Nantahala to recover the costs assigned to it by FERC achieves this same result indirectly—as North Carolina authorities have candidly stated.[32]

[32]For example, the NCUC acknowledged that it effectively modified the FERC-regulated rate schedules; it stated that its action was "nicely suited as a proper alternative to reformation of [the FERC-regulated] contracts." App. 202a.

1. This Court's previous holdings squarely foreclose North Carolina's assertion that States may "indirectly" regulate interstate wholesale transactions, whether by excluding costs that FERC regulates from retail rates or otherwise. They establish that the Federal Power Act preempts any state action or statute that can have the effect of "impair[ing] the Federal Commission's authority to regulate" wholesale sales in interstate commerce, either "directly or indirectly." *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84, 90–92 (1963).[33] Thus, this Court has held that a wide variety of state laws, with far less direct consequences for FERC's regulation than the NCUC's, are preempted. *Id.*

For example, in *Maryland* v. *Louisiana*, 451 U.S. 725 (1981), this Court invalidated a state tax provision on this ground. While the state law did not directly alter a FERC rate schedule, the statute had the "effect" of "shifting the incidence of certain expenses" from the customers whom FERC has found should incur them to a different set of customers and would have "interfer[ed] with FERC's authority to regulate the determination of the proper allocation of costs associated with the [wholesale] sale[s]. . . . " *Id.* at 749–50. Because the NCUC order here nullified FERC's actual interstate allocations of costs between different customers for the only purpose for which they matter, *Maryland* v. *Louisiana* is dispositive.

Even more pertinent are the decisions that establish the "filed rate doctrine" by holding that FERC, and only FERC, has authority to take action that has the effect of modifying a rate that is subject to FERC's jurisdiction. This doctrine protects FERC's

[33]While *Northern Natural Gas* was a case under the Natural Gas Act (15 U.S.C. § § 717–717w) rather than the Federal Power Act, this Court has stated many times that the "relevant provisions of the two statutes 'are in all material respects substantially identical' " and that it is the Court's "established practice" to "cit[e] interchangeably decisions interpreting the pertinent sections of the two statutes." *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 n. 7 (1981) (citations omitted).

exclusive jurisdiction by requiring that FERC rate schedules be treated as lawful in any proceeding and, specifically, by preempting any state law that would have the effect of "authoriz[ing] commerce in the commodity on other terms." *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251 (1951). A state law is preempted even if a court is of the opinion that a different rate "is the only or the more reasonable one." *Id.* at 252. For example, in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578–80 (1981), the Court held that a state's law of contract remedies was preempted insofar as it would have the effect of permitting a utility to recover a higher price than was specified in the rate schedule that was then on file with FERC. Here, of course, the effect of the NCUC order was to authorize commerce on radically different terms than prescribed by the applicable FERC rate schedule, increasing Tennessee's costs by some $45 million. See App. 69a–70a, 244a.

Indeed, the applicability of the filed rate doctrine to this case could scarcely be clearer. FERC Nantahala Rate Schedule No. 1, as filed, determined Nantahala's costs of acquiring power for resale in North Carolina by allocating TVA entitlements capacity (54.3 mW) and energy (360 thousand mWh) to Nantahala. Because FERC had not modified this rate schedule at the time of the NCUC's decision, the NCUC's obligation was to include the costs incurred as a result of this rate schedule in Nantahala's retail rates, with the NCUC having the discretion only to make the rate increase subject to a refund to the extent that FERC thereafter modified the rate schedule in the then-pending complaint proceeding.[34] FERC Opinions 139 and 139A decided that the energy allocation should be increased to 404 thousand mWh, but held that the rate schedule was otherwise "just and reasonable." This necessarily established the new "filed rate" that itself became binding on the North Carolina courts and authorities. Under any view, the rate schedule and decisions foreclosed the

[34]See, *e.g.*, *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358, 1363 (1977), *cert. denied*, 435 U.S. 972 (1978); p. 10 n. 15, *supra*.

NCUC from setting rates, and the North Carolina Supreme Court from affirming them, on the ground that radically greater amounts of low-cost energy (433 thousand mWh) and low-cost capacity (91.1 mW) should have been allocated to North Carolina in 1975.[35]

2. North Carolina's position has also been uniformly rejected by a long line of state supreme court decisions. They hold that, under the Federal Power Act, a state commission may not exclude from retail revenue requirements and rates *any* of the costs that FERC's rate schedules and decisions assign to the utility's ratepayers in that State. The leading decisions are *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978); *Northern State Power Co.* v. *Minne-*

[35]For this reason, there is no substance to the North Carolina Supreme Court's suggestion (App. 91a–98a) that the NCUC could adopt its own radically different interstate allocations of power because FERC subsequently found the agreements "unfair" in Opinion Nos. 139 and 139A. Because FERC rejected the claims that there was any unfairness in the New Fontana Agreement, rejected the claim that the 1971 Allocation Agreement's assignment of 54.3 mW of low cost capacity was unfair, approved an allocation of 404 thousand mWh of energy, and rejected each of the elements of the NCUC's methodology (see pp. 11-14, *supra*), the preemption of the NCUC's actions could scarcely be more complete. The terms and purpose of the Federal Power Act cannot permit a State to use its retail ratemaking proceedings collaterally to attack pending or completed FERC proceedings.

To the extent the North Carolina Supreme Court was relying on the notion, which was urged in Appellees' Motion to Dismiss this appeal (pp. 15–16 n.19), that the FERC decision did not modify the rate schedules, but simply found the contracts to be "unfair" and somehow freed the States to adopt radically different allocations, the short answer to the claim is that it is foreclosed by Section 206 of the Federal Power Act. It provides that when FERC finds any rate to be unfair, FERC "shall determine the just and reasonable rate . . . to be thereafter observed and in force. . . ." App. 256a-257a. Moreover, FERC has also rejected appellees' claim. See Brief for the United States and Federal Energy Regulatory Commission As Amici Curiae In Support of Jurisdictional Statement (October, 1985), pp. 3–4 (FERC decided that "adjustments were required in the 1971 Apportionment Agreement to give a somewhat bigger share of the entitlements from TVA to Nantahala and decided how much that greater share would be").

sota Public Utilities Commission, 344 N.W.2d 374 (Minn.), *cert. denied*, 104 S. Ct. 3546 (1984); and *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981).

In *Narragansett*, the local utility's retail customers sought to avoid a rate increase by claiming that costs incurred under FERC rate schedules should not be included in retail rates. While the state commission conceded that it had no authority to set wholesale rates directly, it, like the NCUC, asserted that it could investigate the reasonableness of the FERC-regulated rate schedules and exclude from the local utilities' revenue requirements those wholesale costs the commission found to be "strikingly" or "glaringly unfair" to local ratepayers. The Rhode Island Supreme Court reversed. It reasoned that, while the States have the authority to determine the retail rates and revenue requirements on the basis of the local utilities' "overall financial structure," under the filed rate doctrine, the Federal Power Act fixes one component of the state commission's determination: it requires that all the costs incurred under FERC rate schedules or decisions must be treated as "an actual operating expense" and included in revenue requirements. 381 A.2d at 1363.[36] This is precisely what the NCUC refused to do here.

[36] It is because FERC's regulation determines only one aspect of the retail revenue requirements that the *Narragansett* court, and other courts, have held that an increase in the FERC regulated wholesale rates need not automatically result in a corresponding increase in retail rates. The reason is that there may be "savings in other areas [of the Company's business] which might offset the increased price for power." *Narragansett, supra*, 381 A.2d at 1363; *accord* cases cited at p. 28 n. 40, *infra*.

Contrary to the North Carolina Supreme Court's suggestion (App. 81a-82a), however, the fact that wholesale rate increases need not *automatically* be "passed through" to retail customers does not mean that some or all of the FERC-regulated expenses can be excluded from revenue requirements. To the contrary, *Narragansett* makes it explicit that this is what the Federal Power Act forbids:

> "[N]o matter what method [the state commission] adopts in considering [a retail utility's] proposed rate increase, it must treat the [FERC] filed and bonded purchase price as an actual operating expense." 381 A.2d at 1363.

The *Northern States* cases involved the very kind of interstate cost allocations that are present in this case. They arose from the abandonment of a nuclear power plant in Wisconsin, which could have been used to supply power in three States. The FERC rate schedules and decisions allocated these abandonment costs between these different States, but both the Minnesota and North Dakota commissions refused to include the local companies' allocated shares in their retail rates and revenue requirements. Each commission thought that the costs should have been allocated to Wisconsin. Both state supreme courts reversed. Despite the fact that no ratepayer had directly benefitted from abandoned plants, each state supreme court held that it would frustrate the purposes of Congress if costs imposed by FERC rate schedules could be investigated by state commissions and excluded from retail rates and revenue requirements. They held the only "proper procedure to determine the reasonableness and prudence of the [allocation of the abandonment] loss as it relates to wholesale charge between [North Dakota, Minnesota, and] Wisconsin" is to invoke the "remedies" available under the Federal Power Act;[37] in turn, state commissions are bound by explicit interstate cost allocations that FERC's regulation approves, either expressly or impliedly.[38] See also *Middle South Energy, Inc.* v. *Arkansas Public Service Commission*, 772 F.2d 404 (8th Cir. 1985).[39]

These state supreme court holdings have been followed by numerous other state supreme courts. These other courts agree that States have no jurisdiction to investigate arrangements

[37] *Northern States Power Co.* v. *Hagen*, *supra*, 314 N.W.2d at 38.

[38] *Northern States Power Co.* v. *Minnesota*, *supra*, 344 N.W.2d at 380-82.

[39] *Middle South* presented an identical attempt by a State to avoid FERC's allocations of costs to it. There, the District Court held the Federal Power Act preempted the state actions, for the same reasons stated in *Northern States* and other cases. The Eighth Circuit, however, did not address the preemption issue because it wished to avoid a novel issue under the Public Utility Holding Company Act that is not presented here. 772 F.2d at 411. Instead, it affirmed the District Court in reliance solely on the Commerce Clause.

regulated by FERC and no power to prohibit the recovery of costs allocated to that State by FERC's regulation, regardless of the state commission's findings whether the costs benefitted local ratepayers.[40] State supreme courts have, without exception, rejected North Carolina's sweeping claims that States may exclude from retail rates costs that FERC's regulation has approved.[41]

[40] For example, when FERC approved rate schedules in which companies increased their wholesale rates to recover the payments made to the Gas Research Institute ("GRI") for a national research and development program related to natural gas, several state commissions sought to exclude the GRI charges from retail rates on the grounds that they benefitted the utilities' shareholders, but not local ratepayers. While state supreme courts each held that this wholesale rate increase need not necessarily lead to an increase in retail rates (see p. 26 n. 36, *supra*), they uniformly have held that state commissions may not investigate whether the GRI payments benefit local ratepayers and are required to treat the charges as reasonable operating expenses and include them in the retail utility's revenue requirements. *Public Serv. Co.* v. *Public Utils. Comm'n*, 644 P.2d 933, 939 (Colo. 1982); *Washington Gas Light Co.* v. *Public Serv. Comm'n*, 452 A.2d 375 (D.C. App. 1982), *cert. denied*, 462 U.S. 1107 (1983); see *United Gas Corp.* v. *Mississippi Pub. Serv. Comm'n*, 240 Miss. 405, 127 So. 2d 404 (1961); *Natural Gas Pipeline Co. of America* v. *Illinois Commerce Comm'n*, 33 Ill. 2d 214, 222, 210 N.E.2d 490, 494 (1965). See generally Hobelman, *The Narragansett Decision And Its Aftermath*, 6 Energy L.J. 33 (1985). The author of this article is the partner of some of appellants' counsel in this case.

[41] Other than the North Carolina Supreme Court's decision in this case, the only cases that even suggest departures from the *Narragansett* holding are *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985), and *Pike County Light and Power Co.* v. *Pennsylvania Pub. Util. Comm'n*, 77 Pa. Commw. Ct. 268, 465 A.2d 735 (1983). In each, the retail utility had purchased power from an affiliate under a contract regulated by FERC, but there was evidence that there were alternative, cheaper sources of power readily available and that the local utility had been imprudent in buying power from its affiliate at a higher price. Both cases hold that a state commission may exclude the excessive payments from the utility's revenue requirements *if*, and *only if*, FERC's regulation has not "expressly or impliedly" approved the utility's actions as in the public interest. *Appeal of Sinclair Machine Products, Inc., supra*, 498 A.2d at 704. These decisions, too, reject North Carolina's position, for Nantahala's power acquisition arrangements were not only impliedly, but expressly, approved by FERC. Indeed, FERC's primary focus was to assure that the terms of the exchange of power were fair to Nantahala and its customers.

(Footnote continued on next page)

The interpretations of the Federal Power Act by the state supreme courts in *Narragansett*, *Northern States*, and other cases are clearly correct. As these decisions show, the Congressional objective in the Federal Power Act of adopting national solutions to interstate conflicts and problems requires that FERC-approved costs be recognized by local ratemakers as expenses for retail ratemaking purposes. Moreover, FERC agrees that this interpretation is essential to the implementation of the Act. It is settled that "the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong . . . ." *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969).[42]

3. If States could investigate FERC's cost and rate determinations and exclude FERC-approved costs from retail rates, it would lead to the very burdens on commerce and duplicative proceedings that the Federal Power Act was enacted to prevent.

This Court need not decide whether *Sinclair Machine Products* or *Pike County* are correct. However, great care is required to assure that FERC's jurisdiction is not impaired by similar state commission orders. For example, while there may be a myriad of circumstances in which FERC would agree that local utility's power acquisition costs can be disallowed (see, *e.g.*, *Pennsylvania Power & Light Co.*, 23 FERC (CCH) ¶ 61,006, at 61,009 (1983)), there are others in which States could misconceive the purposes of FERC's regulation and make prudence determinations that subvert broader national interests. A disallowance order could lead the utility "to seek alternatives to the arrangement" that are "based not on the [overall] public interest, but on which alternative arrangement would best prevent dilution of the [utility's] fair return." *Appeal of Sinclair Machine Products, Inc., supra*, 498 A.2d at 702; see p. 31, *infra*. While the issue is not presented here, this consideration suggests that a State may not disallow acquisition costs on the grounds that it was "imprudent" to contract to purchase power from one source, unless a filing has been made with FERC *and* FERC has made it explicit that it has not found the local utility's contractual arrangement to be prudent and in the overall public interest.

[42] *Accord*, *Northeast Bancorp, Inc.* v. *Board of Governors of the Federal Reserve System*, 105 S. Ct. 2545, 2551 (1985); *American Paper Institute, Inc.* v. *American Electric Power Service Corp.*, 461 U.S. 402, 422 (1983); *Schweiker* v. *Hogan*, 457 U.S. 569, 588 (1982); *Schweiker* v. *Gray Panthers*, 453 U.S. 34, 44 (1981).

Congress enacted the Federal Power Act to assure that individual States could not, by separately pursuing their "respective local interests," burden interstate wholesale sales of energy, which is commerce vital to the nation.[43] Yet if North Carolina is correct that individual States can set retail rates on the basis of their own determinations of how interstate wholesale costs should be divided between different States, these very burdens would result. Each State would have an irresistible incentive to adopt allocations of costs that would advance its "respective local interests" and "benefit its residents to the detriment of its neighbors."[44] And if States acted on these incentives—as they certainly would—the result would be inconsistent state regulations that would inhibit or prevent wholesale suppliers of power from recovering all their costs of generation and transmission.

For example, if Tennessee had regulated retail rates in that State on the basis of the same interstate allocation methodology that North Carolina adopted, the effect would be that Nantahala and Tapoco could recover only 70% of the production and transmission costs through wholesale and retail rates. Tr. Vol. 15, p. 119. The possibility that "uncontrolled state regulation" could impose such a shortfall on interstate power systems would severely inhibit and burden commerce that is vital to the nation. *Cf. Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375 (1983).

[43] Because States would have unavoidable incentives to act in this way, this Court held in *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83, 89–90 (1927), that state regulation of interstate wholesale electric transactions is a *per se* violation of the Commerce Clause. By codifying this "bright line" in the Federal Power Act and declining to overrule *Attleboro* legislatively—as it could have, *Clark Distilling Co.* v. *Western Maryland Ry. Co.*, 242 U.S. 311 (1917); *accord, Northeast Bancorp, Inc.* v. *Board of Governors of the Federal Reserve System*, 105 S. Ct. 2545, 2551 (1985); *Prudential Ins. Co.* v. *Benjamin*, 328 U.S. 408, 427–33 (1946)—Congress plainly intended to foreclose such interference with commerce under any guise.

[44] *Attleboro, supra*, 273 U.S. at 89–90; *Massachusetts* v. *United States*, 729 F. 2d 886, 888–89 (1st Cir. 1984).

North Carolina's position also would give rise to the very economic strife among States that the Commerce Clause sought to prevent. Here, for example, Tennessee has vehemently objected to North Carolina's actions, claiming that they adopt an explicit economic preference for North Carolina, shifting $45 million of costs to Tennessee. See, *e.g.*, App. 106a; p. 38, *infra*. Because Congress enacted the Federal Power Act to promote the historic objectives of the Commerce Clause (see p. 30 n. 43, *supra*), North Carolina's position would create the substantive evils that led to the Act.

North Carolina's position would also permit States to thwart FERC's regulation in subtler ways. If individual States could prohibit local utilities from recovering all the acquisition costs under FERC-regulated contracts, it would provide local utilities with substantial inducements to break the contracts that promote the overall public interest and seek out alternatives that do not. See *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696, 702 (N.H. 1985); pp. 28–29 n. 41, *supra*. The only way to preserve FERC's jurisdiction to assure that power supply arrangements promote the overall public interest, rather than the interests of individual States or groups, is to require state commissions to give effect to FERC rate schedules in retail ratemaking proceedings, subject of course to the outcome of FERC complaint and other proceedings in which States can participate. FERC can then make or oversee any necessary "delicate adjustments" required to coordinate power supply arrangements. *Cf. Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84, 93–94 (1963).

Further, the North Carolina position would mean that interstate rate and cost determinations would no longer be centralized in a single proceeding before a single disinterested federal forum. Rather, the question of whether costs were reasonably incurred, and how the costs should be allocated between different sets of customers in different States could be litigated once before FERC and, again, before each of the many state and municipal commis-

sions that could be affected by the relevant interstate transactions.[45] "Such a result defeats part of the federal objective of providing orderly and streamlined procedures for approval of wholesale transactions." *Appeal of Sinclair Machine Products, Inc., supra*, 498 A.2d at 702.

Indeed, the North Carolina position would do more than permit FERC's determinations to be relitigated, *ad infinitum*, in each of the affected States under traditional public utility standards. Each state commission's reallocation of interestate wholesale costs would be subject to challenge under the Commerce Clause. While the Commerce Clause may be readily applied to invalidate the state action in the instant case (*see* pp. 33–39, *infra*), state rate orders arise in an "infinite variety of cases," *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 390 (1983), and one purpose of the Federal Power Act was to avoid "the necessity" of the very "case-by-ease analys[e]s" under the Commerce Clause that North Carolina's position would require. *Id* at 380; *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 215–16 (1964).

4. Against this background, there is no question that North Carolina's actions violate the Federal Power Act. The NCUC excluded from Nantahala's rates, and revenue requirements, millions of dollars in costs that FERC's regulation has established to have been reasonably incurred by Nantahala. The NCUC did so by adopting radically different interstate allocations of the low-cost power supplies than do the FERC rate schedules and deci-

[45]For example, under North Carolina's position, the question of the appropriateness of one recent wholesale transaction, the System Agreement among the Middle South System companies, would have been subject to litigation in 6 forums: FERC, the Louisiana Public Service Commission, the Arkansas Public Service Commission, the City of New Orleans Council, the Mississippi Public Service Commission, and the Missouri Public Service Commission. See generally *Middle South Energy, Inc.* v. *Arkansas Pub. Serv. Comm'n*, 772 F.2d 404 (8th Cir. 1985).

sions. Indeed, the preemption of North Carolina's actions could not be more complete: each aspect of the NCUC's methodology is contrary to the explicit findings and determinations that FERC made in the Section 206 complaint proceeding. See pp. 11–14, *supra*. Moreover, in making these findings, FERC addressed the arguments of the North Carolina Attorney General, by name, and rejected them. See, *e.g.*, App. 303a–307a.

In short, the Federal Power Act, and FERC's regulation thereunder, prohibit the NCUC from adopting a roll-in or any other device to defeat FERC's cost and power allocations to North Carolina and Tennessee.[46] No matter what method the NCUC adopted in setting Nantahala's retail rates, the Federal Power Act required the NCUC to include all the costs incurred as a result of FERC Nantahala Rate Schedule No. 1 and the pertinent FERC decisions in Nantahala's retail revenue requirements and retail rates.

II. The NCUC Order Violates The Commerce Clause.

Even if the Federal Power Act did not preempt North Carolina's actions, the Commerce Clause, by its own force, would prohibit North Carolina from attempting to impose cost and power allocations that are different from those contained in the FERC rate schedules and decisions. North Carolina's actions impose direct and substantial burdens on interstate commerce, and there is no local interest that can justify either its specific order or its assertion of authority to regulate the specific interstate cost recovery issues. See, *e.g.*, *Edgar* v. *MITE Corp.*, 457 U.S. 624

[46]The fact that North Carolina labeled its methodology a "roll-in" is of no importance to this case. State commissions cannot defeat FERC's power supply determinations and cost allocations by making findings that the "corporate veil" should be pierced, that entities should be rolled-in, or that any other labels be adopted. *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696, 706 (N.H. 1985); *United Gas Corp.* v. *Mississippi Pub. Serv. Comm'n*, 240 Miss. 405, 127 So.2d 404, 420 (1961); *Office of Public Counsellor* v. *Indiana & Michigan Electric Co.*, 416 N.E.2d 161, 164–65 (Ind. App. 1981); *cf.* pp. 11–12, n. 16, *supra*.

(1982) (whether or not state tender offer regulation is preempted by Williams Act, it violates Commerce Clause). Indeed, these very considerations recently led the Eighth Circuit to hold that the Commerce Clause prohibits a State from even investigating interstate cost allocations approved by FERC. *Middle South Energy, Inc.* v. *Arkansas Public Service Commission*, 772 F.2d 404 (8th Cir. 1985).

The applicable standards for reviewing state regulation under the Commerce Clause are well-established. This Court must assess " 'the nature of the state regulation involved, the objective of the state, and the effect of the regulation upon the national interest in the commerce.' " *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 390 (1983). As stated in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970):

> "Where [a] statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." 397 U.S. at 142 (citation omitted).

Here, the balance between national and state interests is clear.

Impact on National Commerce. The NCUC order epitomizes the kind of state interference with interstate commerce that the Commerce Clause was intended to prevent.

Foremost, it is a stark, clear example of "the most serious concern identified in *Bruce Church*—economic protectionism."[47] "Economic protectionism" can be established either by an imper-

[47] *Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, *supra*, 461 U.S. at 394.

missible purpose or impermissible effects. See *Bacchus Imports, Ltd.* v. *Dias*, 104 S. Ct. 3049, 3055 (1984); *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 44 (1980). Here, both the purpose and the effect of the NCUC order is to give North Carolina an absolute preference to a scarce economic resource: the pool of low-cost hydroelectric power generated in North Carolina and Tennessee.

That this was the original purpose of the NCUC order is clear. Its decision responded to the earlier mandate of the North Carolina Supreme Court to give Nantahala's public customers, "in effect, [a] 'first claim' " to the low-cost hydroelectric power generated by Nantahala's facilities in North Carolina.[48] Indeed, the NCUC stated it was going beyond this mandate by also giving North Carolina customers a "first call" to the "total electrical energy" generation of Tapoco's facilities in Tennessee and North Carolina—with Tennessee to have only the "excess" power that remains after North Carolina's needs are met. As the NCUC stated:

> "[T]he allocation methodology that the Intervenors would have the Commission adopt [and that the Commission adopts] is based in all material respects upon the assumption that the electric energy requirements of the Nantahala-Tapoco combined system's North Carolina public load has first call on the total electric energy output of the combined system, and to the extent that said output exceeds the requirements of the North Carolina public load, such excess will be available for sale and will be purchased by Alcoa."

App. 182a–183a. Moreover, the NCUC thereafter reaffirmed these findings in January, 1982. App. 240a.

Since the issuance of this Court's decision in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331, in February, 1982, however, North Carolina authorities have sought to disavow that the NCUC order had this purpose. See App. 101a–103a. These

[48] *North Carolina ex rel. Utilities Commission* v. *Edmisten*, 299 N.C. 432, 434, 438, 263 S.E.2d 583, 586, 588 (1980).

after-the-fact assertions cannot change the order's purpose. In any event, there is no doubt that North Carolina's actions have the effect of creating a first call preference for North Carolina. The NCUC order effectively gives North Carolina not only a far greater share of the low-cost power than does FERC's regulation, but also an *ever-increasing* share. This is because the North Carolina share increases proportionately as the needs of Nantahala's North Carolina customers increase. See p. 13, *supra*. Thus, as the sponsor of the NCUC order's methodology testified, the methodology assures that North Carolina will have all the low-cost hydroelectric power generated in the two States within eight years and that Tennessee will have none. See p. 11, *supra*. This epitomizes the economic protectionism that the Commerce Clause was designed to prevent. *New England Power Co.* v. *New Hampshire, supra;* see also *Philadelphia* v. *New Jersey*, 437 U.S. 617 (1978).

The North Carolina Supreme Court held (App. 100a–101a) that the NCUC was not guilty of protectionism because it did not actually block the physical exportation of low-cost power to Tennessee.[49] All it did, rather, was secure the economic benefits of the low-cost power for North Carolina's citizens alone. For Commerce Clause purposes, this is a distinction without a difference, and North Carolina's position was rejected in *New England Power Co.* v. *New Hampshire, supra.* There, the State did not prohibit the physical exportation of cheap hydroelectric power by "order[ing] New England Power to sever its connections" with the interstate grid. 455 U.S. at 336. Instead, it sought to impose wholesale rate schedules that would give that States' citizens the exclusive economic benefits of the hydroelectric energy generated in that State. *Id.* at 336; see also *id.* at 343–44 n.10. This is precisely what North Carolina has attempted here. Moreover, North Carolina has gone a step further than did New Hampshire.

[49]The North Carolina Supreme Court also noted that the State had not physically appropriated the low-cost power generated in Tennessee. App. 100a–101a.

By seeking also to appropriate the benefits of hydroelectric power generated in Tennessee, North Carolina has carried protectionism to new heights.

Further, North Carolina is directly regulating an area of almost exclusively national concern: interstate wholesale sales and exchanges of power between two States. While modern principles of Commerce Clause jurisprudence no longer treat wholesale power sales as *per se* beyond the power of state regulation to affect, they reiterate the overriding national interest in such commerce; state regulation that directly affects interstate power exchanges must withstand careful scrutiny to be valid. See *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 377-79, 390, 393 (1983); *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927).[50] This consideration is acute here because North Carolina has not just inhibited sales from North Carolina to Tennessee, has not just prohibited a local utility from recovering all its power acquisition costs, and has not just appropriated the economic benefits of power generated in Tennessee. It has forced an out-of-state, Tennessee manufacturing plant to subsidize North Carolina ratepayers by allocating $45 million in costs to the "Alcoa manufac-

[50]*Arkansas Electric Cooperative Corp.* overruled *Attleboro's* holding that state regulation of interstate wholesale sales of power is *per se* invalid, on the ground that this *per se* rule is inconsistent with modern day doctrine. At the same time, *Arkansas Electric Cooperative Corp.* emphasized that the considerations underlying the "line" drawn in *Attleboro* "would undoubtedly lead in a large number of cases to results entirely consistent with present-day doctrine" and are a "healthy counterweight in many contexts to an otherwise too-easy dilution of guarantees contained in the Constitution." 461 U.S. at 393. Indeed, in upholding state regulation in that case, *Arkansas Electric Cooperative Corp.* emphasized that what was almost exclusively at issue there were *intrastate* wholesale sales. *Id.* at 395. Lower courts have thus acknowledged the continuing importance of *Attleboro* and its predecessors to Commerce Clause jurisprudence. *Baltimore Gas and Electric Co.* v. *Heintz*, 760 F.2d 1408, 1420-21 (4th Cir.), *cert. denied*, 106 S. Ct. 141 (1985).

turing load" (App. 244a) and requiring it to "refund" these amounts to North Carolina customers. North Carolina's actions thus impose a "direct restraint on interstate commerce [with] a sweeping extraterritorial effect." *Edgar* v. *MITE Corp.*, 457 U.S. 624, 642 (1982).

Beyond question, North Carolina's actions have a substantial, and not an incidental, effect on interstate commerce. It is for this reason that Tennessee has urged, repeatedly, that North Carolina's actions of, in its words, "effectively allocat[ing]" $45 million in costs from North Carolina to Tennessee (App. 69a-70a) will have serious adverse repercussions for the economy in eastern Tennessee. See App. 106a; Brief of Tennessee As Amicus Curiae In Support Of The Jurisdictional Statement (October, 1985).

The Local Interests. The burden and interference with interstate commerce being clear, the remaining question is whether North Carolina's decision to make its own determination of how interstate wholesale costs should be allocated and recovered advances any legitimate local interests that are sufficiently compelling to outweigh these burdens. The state interest in engaging in this regulation must be assessed against the background of the protections that federal law already provides. *Edgar* v. *MITE Corp.*, 457 U.S. at 644-45 (1982); see *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, *supra*, 461 U.S. at 393 (emphasizing inportance of absence of federal regulation in that case).

Here, North Carolina's regulation is designed to protect local ratepayers. It seeks to assure that its retail ratepayers are not saddled with costs that were not reasonably incurred for their benefit, but that, instead, were incurred to benefit an Alcoa plant in Tennessee. In this regard, North Carolina also wants to assure that "corporate abuses" are not permitted to lead to the same result.

While the protection of local ratepayers is a legitimate interest, the overriding fact is that the Federal Power Act provides the "same substantive protections" with respect to the interstate cost allocations at issue. *Edgar* v. *MITE Corp.*, 457 U.S. at 644-45. Indeed, the Federal Power Act did more than give FERC jurisdiction to apply the same basic principles of utility law that North Carolina has invoked. It provided the Attorney General, and its citizens, with a fully adequate remedy to prevent unfair and unreasonable costs allocations. A disinterested forum, FERC, has considered, and rejected, each of the specific factual allegations that underlie the claim that North Carolina ratepayers were being assigned excessive cost burdens—in an extensive proceeding in which the North Carolina Attorney General represented its citizens' interests.

While North Carolina's ratepayers, to be sure, have an interest in having an interested forum revisit these issues and adopt different findings and protections that "go beyond" FERC's, this interest cannot be sufficient to authorize the direct and substantial interference with interstate commerce that is presented here. See *Edgar* v. *MITE Corp.*, *supra*, 457 U.S. at 644-45. States do not, and cannot, have a carte blanche collaterally to attack any judicial or administrative determination that disadvantaged its residents, and favored out-of-state interests. This is especially so because the reallocations that North Carolina has made are the kinds of explicit economic preferences that are virtually *per se* illegitimate. See *Philadelphia* v. *New Jersey*, *supra*, 437 U.S. at 627.

CONCLUSION

For the reasons stated, the decision and judgment of the North Carolina Supreme Court should be reversed.

Respectfully submitted,

REX E. LEE*
DAVID W. CARPENTER
SIDLEY & AUSTIN
1722 Eye St., N.W.
Washington, D.C. 20006
(202) 429-4000

Counsel for Appellants

Of Counsel:

RONALD D. JONES
DAVID R. POE
M. REAMY ANCARROW
LEBOEUF, LAMB, LEIBY & MACRAE

EDWARD S. FINLEY, JR.
WILLIAM D. JOHNSON
GRADY L. SHIELDS
HUNTON & WILLIAMS

Dated: January 22, 1986

**Counsel of Record*

APPENDIX

Section 313 of the Federal Power Act, 16 U.S.C. § 825*l*(b) provides as follows:

§ 825*l*. Review of orders

(b) Judicial review

Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States Court of Appeals for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy or such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of Title 28.

NO. 85-568 (17)

IN THE

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

APPELLEES' BRIEF

LACY H. THORNBURG
ATTORNEY GENERAL
OF NORTH CAROLINA

Richard L. Griffin
Assistant Attorney General
N.C. Department of Justice
Suite 207
Hayes & Hobson Building
20 South Spruce Street
Asheville, N.C. 28801
(704) 258-6083

Attorneys for: Using and Consuming Public

CRISP, DAVIS, SCHWENTKER PAGE & CURRIN

William T. Crisp
Counsel of Record
Robert F. Page
320 South Salisbury Street
Post Office Box 751
Raleigh, North Carolina 27602
(919) 833-2556

Attorneys for: Henry J. Truett; Cherokee, Graham and Jackson Counties: Towns of Andrews, Bryson City, Dillsboro Robbinsville and Sylva; Swain County Board of County Commissioners; and the Tribal Council of the Eastern Band of Cherokee Indians

THE PUBLIC STAFF
N.C. UTILITIES COMMISSION

Robert Gruber,
Executive Director
James D. Little, Staff Attorney
Post Office Box 29520
Raleigh, N.C 27626-0520
(919) 733-6110

Attorney for: Using and Consuming Public

48 pp

QUESTIONS PRESENTED

1. Is federal preemption mandated under the Federal Power Act where a State's utilities commission sets fair and reasonable intrastate retail rates using an accounting method (roll-in) which recognizes all relevant costs, in order to reach the resulting fair and reasonable retail rates and where the utility company's parent company (Alcoa) has left the utility company "...an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina"?

2. May the Commerce Clause of the Constitution of the United Stated be successfully invoked by a parent utility company to block a State's utility commission from utilizing an accounting method (roll-in) to achieve fair and reasonable intrastate retail rates for the captive company (Nantahala) and the using and consuming public of North Carolina when the methodology does not allocate or interfere with the interstate flow of electric power?

THIS PAGE LEFT BLANK INTENTIONALLY

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES

CONSTITUTIONAL PROVISIONS INVOLVED

STATUTES PRESENTED

MISCELLANEOUS

IN THE

Supreme Court of the United States

October Term, 1985

NO. 85-568

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

APPELLEES' BRIEF

OPINIONS BELOW

Appellants' discussion of the central issue of federal preemption is incomplete without reference to the companion Nantahala wholesale cases at the Federal Energy Regulatory Commission ("FERC"). The relevant decisions are: (1) FERC Opinion 139 in Docket Nos. ER 76-828-000 and EL 78-18-000, issued May 14, 1982 (19 F.E.R.C. §61,152); (2) FERC Opinion 139-A in the same Dockets, issued September 30, 1982 (20 F.E.R.C. §61,430); and (3) the Opinion of the United States Court of Appeals for the Fourth Circuit in *Nantahala Power and Light Co. v. FERC*, 727 F.2d 1342 (4th Cir. 1984). Appellants printed only excerpts from Opinions 139 and 139-A in their Appendix to the Jurisdictional Statement ("A.J.S."), and omitted the Fourth Circuit's opinion. Hence, Appellees have filed 18 copies of the FERC and 4th Circuit Opinions with the Court.

STATUTORY PROVISIONS

1. N.C. Gen. Stat. §62-3(23)c. Definitions [of Public Utilities].

2. N.C. Gen. Stat. §62-133(b). How [utility] rates fixed. (Both sections set forth in full text in Appendix hereto.)

STATEMENT OF THE CASE

1. Appellants' Statement Of The Case Contains Factual Errors And Is Otherwise Misleading.

Appellants' factual errors and misstatements are so pervasive that, effectively, they argue a phantom Case on Appeal which has been rejected by every court which has fully reviewed the facts and law involved in this unique situation. We call attention only to seven basic errors which appear in the Appellants' Statement of the Case. These are:

(1) The North Carolina Utilities Commission ("NCUC") refused to give effect to FERC-approved rate schedules (Appellants' Brief or "Brief", pp. 4, 10, 14, 15);

(2) The NCUC made independent determinations of the reasonableness of interstate cost and power allocations (Brief, pp. 9, 14);

(3) The NCUC assigned more low cost power to Nantahala Power and Light Company ("Nantahala") than the FERC. (Brief, pp. 10, 14);

(4) The 1971 Nantahala-Tapoco Apportionment Agreement ("1971 Agreement") allocates power between North Carolina and Tennessee (Brief, p. 5);

(5) Tennessee receives only such power as is left after allocation of power to Nantahala (Brief, p. 14);

(6) The Alcoa refund requirement was due to Alcoa's capacity as a resident of Tennessee or as a customer of Tapoco (Brief, p. 15); and

(7) The roll-in methodology gives North Carolina retail customers a "first call" preference to the hydroelectric power (Brief, p. 11).

2. Appellees' Statement Of The Case Actually Tried and Decided Below.

This case involves the setting of intrastate retail electric rates for customers of Nantahala. All parties concede such rates are subject to the exclusive jurisdiction of the NCUC. After conducting extensive hearings, the NCUC determined fair and reasonable retail rates for both Nantahala and the North Carolina retail customers. In fixing such rates, the NCUC was aware of Nantahala's total domination by its parent, the Aluminum Company of America (Alcoa), as well as Alcoa's total domination over Tapoco, Inc. (Tapoco), Nantahala's sister company. Nantahala and Tapoco are wholly-owned subsidiaries of Alcoa (collectively referred to at times as the "Alcoa Power System"). Alcoa's control had been exercised for Alcoa's benefit to the detriment of both Nantahala, alone, and the North Carolina retail customers. The NCUC was aware of Alcoa's repeated attempts (See, e.g., A.J.S., pp. 19a-32a and footnotes 5 and 10) to frustrate state and federal efforts: (a) to effectively regulate the Alcoa Power System; (b) to prevent Alcoa from granting unlawful preferences to itself as a customer of the system; and, (c) to prevent Alcoa's further efforts to remove from the public domain hydroelectric resources which were licensed to serve the needs of the consuming public.

In late 1976, Nantahala filed an application before the NCUC for an increase of $1,830,791 in its retail electric rates. The Nantahala and Tapoco plants and facilities are located adjacent to and are physically interconnected with each other. Nantahala's total plant is in North Carolina while Tapoco's plant is partially in North Carolina and partially in Tennessee. Both are North

Carolina public utility companies and both hold certificates of convenience and necessity in North Carolina to serve the using and consuming public.

With notice to Alcoa and Tapoco, and after initial hearings fully participated in by them, the NCUC determined that they were North Carolina public utilities and proper parties to the cause (R., Vol. I, pp. 76-88).

Central to this case are two agreements: the 1962 New Fontana Agreement ("NFA") and the 1971 Apportionment Agreement ("1971 Agreement").

1. The NFA (Ex. Vol. 1, Item 40, New Fontana Agreement), was a contract between Nantahala, Tapoco, and Alcoa, on the one hand, and the Tennessee Valley Authority ("TVA") on the other, by the terms of which Nantahala and Tapoco turned over, at generation, virtually all of their power[1] to TVA and received, in return from TVA, power of a finite quantity to be divided among the three companies as Alcoa decided. Under this Agreement, Nantahala and Tapoco are treated as a combined power system. The NFA did not establish the power costs of the individual companies and is merely a power exchange (i.e. barter) agreement. Although not a typical 'sale' of power, the NFA is, nonetheless, a "rate schedule" which was "filed" at FERC in 1966, some four years after its execution.

2. The 1971 Agreement was a contract imposed upon Nantahala and Tapoco by Alcoa to divide the return power entitlements from TVA under the NFA. The 1971 Agreement did not, in and of itself, establish power costs of either Nantahala or Tapoco for wholesale or retail ratemaking purposes (Ex. Vol. 4, Item 29, A. G. Jontz Cross Exam Ex. 3). FERC found this Agreement to be unfair and unreasonable as to Nantahala (A.J.S. pp. 281a, 290a, 293a) and did not follow it in establishing Nantahala's wholesale rates (A.J.S. p. 275a approved by Opinion 139, A.J.S. pp. 284a-301a). FERC also found this Agreement does not constitute a "sale" of power between Nantahala and Tapoco (A.J.S. p. 292a).

[1]Tapoco turned over all of the power generated at its four dams, while Nantahala turned over all of the power from its eight principal dams. Power from Nantahala's three smallest, run-of-the-river facilities was kept by Nantahala. The total output of Nantahala's eleven dams was, and is, only about one-quarter of the output of Tapoco's four dams.

The NCUC conducted extensive general rate case hearings, in which all parties offered considerable evidence concerning, *inter alia*, the NFA and 1971 Agreement together with evidence as to the use and effect of the roll-in methodology.

On September 2, 1981, the NCUC entered its order (A.J.S. pp. 165a-235a) implementing roll-in based upon findings that: (1) Tapoco is a North Carolina public utility; (2) Tapoco and Nantahala operate a single, unified electric public utility system; (3) Pursuant to N. C. Gen. Stat. §62-3(23)c, Alcoa, the 100% parent of Nantahala and Tapoco, is a North Carolina public utility to the extent of its effect on Nantahala's retail rates and services; and (4) Alcoa has dominated Nantahala for its own benefit, to the detriment of Nantahala and its retail ratepayers.[2]

Having determined that Tapoco was a North Carolina public utility[3] and that Tapoco and Nantahala operate a single, integrated electric public utility system, the NCUC: (a) joined the 1975 test year assets, properties, plants, working capital requirements, etc., of the two companies, into one unified rate base (A.J.S. pp. 176a-177a); (b) totaled the test year revenues of the companies (A.J.S. p. 177a); (c) totaled the test year operating expenses of the companies (A.J.S. p. 177a); and (d) assigned one rate of return to the total rate base assets of the two companies[4] (A.J.S. p. 178a).

[2]All of these facts have been established by substantial competent evidence and upheld on appeal. Appellants do not contest them in this Court. *Herb v. Pitcairn*, 324 U.S. 117, 125-126 (1954).

[3]Tapoco, as Nantahala's sister corporation, is 100% owned by Alcoa (A.J.S. p. 175a). Tapoco functions solely as the Power Supply Department of Alcoa's Tennessee Operations and Alcoa buys Tapoco's power at a price "...totally unrelated to the true value of the Tapoco energy actually received by Alcoa." *Utilities Commission v. Edmisten*, 299 N.C. 432, 439, fn 4; 263 S.E.2d 583 (1980).

[4]The Nantahala rate of return was used since Tapoco is less risky than Nantahala.

From these elements, the single system revenue requirement [reasonable operating expenses plus (rate base X rate of return)] was derived as required by N.C.Gen. Stat. §62-133(b) (set forth in full in Appendix). The single system's cost of service was then allocated between the respective loads which it served (A.J.S. p. 222a).[5] This is all that "roll-in" methodology means.

The level of Nantahala "stand-alone" book costs were not considered appropriate as the sole basis for cost allocation purposes because: (1) Nantahala was not a "stand-alone" company; (2) Nantahala - Tapoco is physically a single, integrated system of hydroelectric power generation, although they are separate corporations; (3) neither the NFA nor the 1971 Agreement was a cost allocation Agreement; and (4) neither Agreement could be used for cost allocations of a single Nantahala/Tapoco system.

The NCUC found that 24.6% of the *demand* costs and 24.51% of the *energy* costs (A.J.S. p. 221a) of the single system should be allocated to Nantahala's retail cost of service[6] (A.J.S. p. 221a). These are actual, not assumed, capacity and energy calculations.

Because the Nantahala-Tapoco single system's average costs are lower than the costs for Nantahala viewed as a "stand alone" company (A.J.S. p. 293a), which it was not designed to be (A.J.S. p. 181a), use of the roll-in methodology reduced Nantahala's annual revenue requirements by about $4,500,000 below the level indicated if Nantahala had been treated as a "stand alone" company for retail rate purposes.

[5]The NCUC makes the same kind of allocation in setting rates for other interstate companies, such as Duke Power and Carolina Power and Light, which operate in more than one state.

[6]"Electric rates are generally based on the cost of rendering service." Many rate schedules consist of two parts, a demand charge and an energy charge...The *demand* component of the rate schedule is devised to provide for the expenses incident to furnishing facilities and plant to meet customer demand. The *energy* component is designed to meet fuel costs for generating current and day to day operating expenses." *Utilities Commission vs. Area Development, Inc.*, 257 N.C. 560, 562; 126 S.E.2d 325 (1962).

Alcoa is present in the case because "... [I]n essence, Alcoa was found to have been a 'public utility' having an effect on Nantahala's rates and services for many years. Based upon this finding and upon the Commission's findings of detrimental domination,[7] Alcoa can properly be held to pay any refunds[8] Nantahala is ordered to pay in this proceeding, but is unable to satisfy out of its own financial resources ..."[9] Upon appeal by the Companies of the NCUC orders, the North Carolina Court of Appeals and the North Carolina Supreme Court affirmed all relevant findings.

Alcoa and Tapoco (but not Nantahala) filed a complaint in the United States District Court, seeking to enjoin the NCUC's actions. The District Court dismissed on abstention grounds. On appeal by Alcoa, the Fourth Circuit affirmed[10] noting the NCUC order "...on its face sets only retail, intrastate rates, an important matter traditionally within the sole discretion of the states, and does not directly conflict with FERC's wholesale and interstate rate setting power."[11]

Every court which has reviewed the facts and applicable law, in this novel and unique fact situation, has rejected Alcoa's attempts to *avoid regulation* and to *federalize* its unreasonable and publicly detrimental conduct in controlling the Nantahala-Tapoco hydroelectric power system for its own purposes.

[7]"Alcoa has so dominated these transactions and agreements affecting its wholly owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina...(A.J.S. p. 233a).

[8]Nantahala's initial refund plan was rejected and Nantahala and Alcoa were required to file a joint refund plan (R. Vol. II, pp. 322-326). Alcoa declined to participate in a plan to divide the refund obligation between Alcoa and Nantahala (R. Vol. II, pp. 354-356). The NCUC was ultimately forced to adopt its own refund plan (R. Vol. II, pp. 377-381). At simple interest the amount of refund now due is approximately thirty million dollars.

[9]*Utilities Commission v. Edmisten*, 313 N.C. 614, 737; 332 S.E. 2d 397 (1985).

[10]*Aluminum Company of America v. Utilities Commission*, 713 F. 2d 1024 (4th Cir., 1983); *cert. denied* 104 S.Ct. 1326 (1984).

[11]Footnote 10, *Id.*, 713 F.2d at 1030.

The NCUC's orders do not: (l) disregard FERC-approved power allocations or agreements; (2) assign to Nantahala more low cost power than FERC did; (3) allocate any costs to Tapoco, much less to Tapoco's customer Alcoa; or, (4) require that Tennessee receive only the amount of power left after allocation of power to Nantahala. The roll-in only allocated Nantahala's intrastate retail costs by an accounting method used to accurately reflect the Nantahala retail customers cost responsibility portion of the Nantahala-Tapoco single system. Roll-in does not affect any power flows to TVA, Tapoco, Nantahala or Alcoa.[12]

While the NCUC Order states that the North Carolina retail customers should be given a "first call" on the North Carolina-produced hydroelectric power (A.J.S. p. 183a), the North Carolina Supreme Court, in review, determined that the "first call" language in the NCUC Order was not what the roll-in, in fact, accomplished (A.J.S., pp. 101a-103a). In fact, nowhere in the NCUC order do North Carolina customers receive a preference of hydroelectric power over Tennessee's customer. For Appellants to advance the "first call" preference proposition is disingenuous and bottomed upon the proposition this Court will not grasp the true situation.[13]

[12]"This device does nothing more than recognize that the two corporate entities ought, for rate making accounting purposes, be treated as the one electrical power producing and distribution system which, in fact, they are." *Utilities Commission v. Edmisten*, 299 N.C. 432, 443; 263 S.E.2d 583 (1980).

[13]The "first call" idea comes from a single witness's testimony based upon a hypothetical question. The question was whether the witness's method of cost allocations, *using a hypothetical replacement for the NFA*, designed to reflect a fair treatment of the public load, would be different than his actual allocations, *based upon the existing NFA*. In response to this hypothetical, he answered "yes", that in such event *he would give* the public load "first call" (Tr. Vol. 15, pp. 65-66). That answer does not relate to the roll-in methodology actually employed by the witness or adopted by the NCUC.

3. *The Related FERC Cases.*

On July 30, 1976, Nantahala filed a wholesale rate case in FERC Docket ER 76-828, seeking to increase its wholesale rates, affecting three wholesale customers, by the annual amount of $121,908 (A.J.S. p. 269a), which was consolidated for hearing with a complaint proceeding instituted by one of Nantahala's wholesale customers (Docket EL 78-18).

An initial decision was rendered by the Administrative Law Judge ("ALJ")[14] on April 10, 1981 who refused to set Nantahala's wholesale rates on the basis of the NFA and the 1971 Agreement. He also declined to "pierce the corporate veil" between Alcoa and Nantahala or to apply a roll-in methodology for wholesale ratemaking, because:

> ...a more appropriate relief is available. This relief is to set rates for Nantahala *as if* the 1971 Apportionment Agreement were reformed to reflect a fair allocation of power and energy to Nantahala (A.J.S. p.275a), (Emphasis supplied).

On review, FERC also declined to fix Nantahala's wholesale rates based upon the power allocations provided by the NFA and the 1971 Agreement. Instead, FERC set Nantahala's wholesale rates by hypothetically allocating to Nantahala 44 million kwh of annual power to which Nantahala was not entitled under the 1971 Agreement. This allocation was a substantial deviation from the FERC filed rates. The FERC stated that its decision would set just and reasonable rates for Nantahala to charge its wholesale customers (A.J.S. p. 312a). In its No. 139 Opinion, FERC did not allocate power as between North Carolina and Tennessee, nor did FERC allocate the cost of power for purposes of retail ratemaking. In Docket No. ER 81-19-000 (A.J.S. pp. 262a-266a), it is clear that FERC did not accept the 1971 Agreement for any allocation purpose. The Agreement itself divides power, but not

[14]The hearing judge, Graham McGowan, retired (and died), and Jacob Leventhal issued the initial decision. Excerpts of Judge Leventhal's opinion are printed on pp. 267a-282a of the A.J.S.

costs (Ex. Vol. 4, Item 29, A. G. Jontz Cross Exam. Ex. 3), particularly not the costs of a single system. Indeed, as stated in the ER 81-19 order, Tapoco argued that the Agreement set neither rates nor charges (A.J.S. p. 264a). When the FERC subsequently set Nantahala's wholesale rates in Docket Nos. ER 76-828 and EL 78-18, it did not follow the 1971 Agreement for purposes of cost allocation. *FERC did not provide any actual additional power to Nantahala. FERC did not increase or lessen the power actually received by TVA, Alcoa, Nantahala or Tapoco and did not modify Tapoco's FERC (Alcoa) rates, the NFA, or Tapoco's actual sales to Alcoa. As to Nantahala, Tapoco, Alcoa and TVA, there was absolutely no change in the power which flowed or the costs incurred under the FERC-filed rate schedules.* The only thing FERC did was to adjust Nantahala's wholesale costs as if Nantahala had received additional power (App. pp. 293, 295a-296a).

SUMMARY OF ARGUMENT

1. The NCUC'S Orders Do Not Violate The Preemption Doctrine.

The facts of this case are unique in the electric power industry. The NCUC made four essential findings of fact: (1) Tapoco is a North Carolina public utility; (2) Alcoa is a North Carolina public utility; (3) the plants and facilities of Tapoco and Nantahala form a single, integrated electric system, and (4) Alcoa has so dominated Nantahala that Nantahala is unable to protect itself, much less its retail customers. The NCUC's roll-in methodology follows as a natural consequence of these findings.

FERC found that the 1971 Agreement was unfair to Nantahala and did not consider itself bound by the 1971 Agreement in setting Nantahala's wholesale rates. Accordingly, the NCUC's roll-in is not subject to preemption for at least five reasons in addition to the unique facts of this case.

First, the FERC itself, in Docket Nos. ER 76-828 and EL 78-18, set Nantahala's wholesale rates by theoretically assigning power to Nantahala without reforming the 1971 Agreement. Under

the "filed rates" doctrine, FERC, in setting rates fair and reasonable under Section 205 of the Federal Power Act, is as bound by agreements accepted for filing as is a state's utility commission in setting fair and reasonable retail rates. *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577-578 (1981). Neither sovereign can surrender its obligation to protect the public from unjust, unfair and unreasonable rates. The federal preemption doctrine does not require such a result.

Second, the 1971 Agreement, at most, merely divided the TVA return power entitlements between Nantahala and Tapoco. It did not apportion costs, particularly not the costs of the single Nantahala-Tapoco system. The NFA is totally silent with respect to the allocation of either power or costs.

Third, Federal and State regulatory commissions can adopt different ratemaking methodologies which result in fair, just and reasonable rates at both wholesale and retail levels. 16 U.S.C. §823(e)(1); *Mid-Tex Electric Cooperative, Inc. v. FERC*, 773 F.2d 327 (D.C. Cir., 1985).[15] In its Opinions 139 and 139-A, FERC recognized that it was not bound by the NCUC's use of the roll-in or the NCUC's findings that Nantahala/Tapoco constitute a single system and that Tapoco was a North Carolina public utility. The converse of that proposition is also true.

Fourth, the *Narragansett/Northern States* line of cases is inapplicable to this current case because, in those cases, the State commissions attempted either to avoid passing on to retail ratepayers a FERC-approved cost or to reallocate a cost which FERC had specifically and directly allocated to a state or a retail utility company. In this case, all relevant costs were recognized; none were excluded; and no costs specifically allocated by FERC were reallocated, with the result that the current case is outside of the *Narragansett/Northern States* line of cases.

---

[15]For example, the states are free to accept FERC's Uniform System of Accounts or they may require their own separate accounting system. 16 U.S.C. §825(a). See also 16 U.S.C. §§824b(a), 824c(a) and 824g for other examples where state methodologies may differ from FERC's. Also, see *Jersey Central Power and Light Co. v. FPC*, 319 U.S. 61, 74-75 (1943).

Fifth, a developing line of cases, epitomized by ***Public Service Co. of Colorado v. Public Utilities Comm. of Colorado***, 644 P.2d 933 (Colo. 1982), recognizes that the preemption doctrine does not preclude a state utility commission from determining whether certain FERC-approved costs are to be borne by the retail ratepayers or the stockholders.

2. *The NCUC'S Orders Do Not Violate The Commerce Clause.*

The roll-in neither diverted, directly or indirectly, any power from Tapoco/Alcoa to Nantahala nor created a preference for North Carolina ratepayers. Thus, there was no intrusion upon interstate commerce so as to constitute a violation of the Commerce Clause of the United States Constitution. The preference prohibition of *New England Power Company v. New Hampshire*, 455 U.S. 331 (1982) (hereafter, "NEPCO") is not applicable. The roll-in was not implemented to create a preference for North Carolina; instead, its sole purpose was to set just and reasonable retail electric rates for an Alcoa subsidiary which was dominated by Alcoa for Alcoa's benefit and to the retail ratepayers' detriment. The roll-in is the least intrusive retail ratemaking method available to protect the retail using and consuming public from unjust and unreasonable rates.

Any economic benefit arguably favoring North Carolina retail ratepayers flowed from an evenhanded regulation of a legitimate local public interest and placed only an indirect, incidental burden (if any) on interstate commerce. This result is clearly permissible under the test this Court laid down in *Pike v. Bruce Church*, 397 U.S. 137 (1970).

ARGUMENT

Introduction

The constitutional principles of preemption, in whatever particular field of law they operate, are designed with a common

end in view to avoid conflicting regulation of conduct by various official bodies which might have some authority over the subject matter. *Amalgamated Assn. of Street, Electric Ry. & Motor Coach Employees v. Lockridge*, 403 U.S. 274, 285-286 (1971). In the final analysis, there can be no one crystal clear distinctly marked formula. The Court's primary function is to determine whether, under the circumstances of this particular case, the NCUC's order stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Justice Brennan wrote: "The principle to be derived from our decisions is that federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons - either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained." *Florida Lime & Avocado Growers v. Paul*, 373 U.S. 132, 142 (1963).

The facts of this case are unique in the electric power industry.[16] Nantahala is simply not like or comparable to Narragansett Electric Company. The Nantahala-Tapoco single system is not like or comparable to Northern States Power Company or other electric holding company systems, such as Middle South Utilities, the Southern Companies System or the American Electric Power System. Thus, while Appellees have no quarrel with the general principles enunciated in Appellants' Supremacy Clause and Commerce Clause cases, such principles have no relevance to the case at bar, because the instant facts are so dramatically different from the facts of the cases relied upon by Appellants. Moreover, none of the cases relied upon by Appellants and their allies involve FERC-filed agreements that: (a) were found to be unfair by the FERC, (b) did not allocate costs between wholesale and resale customers, and (c) were not followed by the FERC itself in setting wholesale rates.

In all of these cases, the State utility commissions clearly interfered with FERC-approved power and cost allocations, which the NCUC did not do. In no other case relied upon by Appellants

[16]For summary of relevant facts see: A.J.S. pp. 13a, 32a, 166a-235a.

is the parent corporation engaged in a principal manufacturing business which is separate and apart from the production, transmission and distribution of electric power. In no other case is the parent, in its separate manufacturing operations, the largest (by far) customer of its own power system. In no other case has the parent been caught awarding unlawful preferences and benefits to itself, *Utilities Commission v. Mead Corporation*, 238 N.C. 451; 78 S.E. 2d 290 (1953. The veil of corporate separateness between parent and subsidiaries has not been pierced in most of these cases. In no other case is there a consistent history of the parent attempting to remove resources dedicated to the public's service from the public domain, for its own sole, private and exclusive use. *Utilities Commission v. Membership Corporation*, 260 N.C. 59; 131 S.E. 2d 865 (1963).

I. THE PREEMPTION (FILED RATES) DOCTRINE, DOES NOT PRECLUDE THE NCUC FROM SETTING NANTAHALA'S RETAIL RATES USING A ROLL-IN METHODOLOGY.

A. *Analysis Of The Federal Power Act And The Narragansett/Northern States Line Of Cases Clearly Shows That The Preemption (Filed Rate) Doctrine Is Not Applicable To The Current Case.*

A long line of cases has laid down the "filed rate" doctrine, recognizing the FERC's exclusive right to pass upon certain matters affecting wholesale electric rates and the interstate transmission of electricity, so as to preclude inconsistent state action. As a necessary adjunct to the 'bright line' test established in *FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964), *(Colton)*, whenever the FERC has accepted for filing and approved wholesale rates of a FERC-jurisdictional utility, state regulatory commissions may not conduct their own independent investigation concerning the reasonableness of the wholesale rate *so as to interfere with the filed rate.* Under the *Colton* rule, the FERC, pursuant to Article VI, Clause 2 of the United States Constitution and the Federal Power Act (16 U.S.C. 791a-828c), has the exclusive right to set wholesale, interstate power rates for its

jurisdictional utilities. Appellees fully accept the "bright line" doctrine as stated in the *Colton* case. It necessarily follows that, while the state commissions may not cross the "bright line" and interfere with FERC's wholesale, interstate ratemaking authority, FERC is equally forbidden to cross the "bright line" so as to interfere with the rights of state commissions to set the just and reasonable level of retail rates and charges for intrastate utility service.[17]

Since this Court first announced the "bright line" rule in *Colton*, virtually all of the leading cases concerning federal preemption have been decided at the State level. In *Narragansett Electric Co. v. Burke*, 119 R.I. 559; 381 A.2d 1358 (1977), *cert. denied* 435 U.S. 972 (1978), the Rhode Island Commission engaged in a searching inquiry into a wholesale supplier's *costs* and concluded that the wholesale rates charged to and paid by a local utility for purchased power were unreasonable. The State Supreme Court decreed that the Commission's action violated the wholesale rate structure on file with and approved by FERC. A similar filed rate violation was found in *United Gas Corp. v. Mississippi Public Service Commission*, 240 Miss. 405; 127 So. 2d 404 (1961), where the Mississippi Commission refused to allow in retail rates certain wholesale purchased gas *costs* which it found to be unreasonable. In *City of Chicago v. Illinois Commerce Commission*, 13 Ill. 2d 607; 150 N. E. 2d 776, 780-81 (1958) and *Citizens Gas Users Assoc. v. Public Utilities Commission of Ohio*, 165 Ohio 536; 138 N.E. 2d 383 (1956) the respective courts held that state commissions could not disallow, from retail operating expenses, the *cost* of gas purchased at wholesale under FPC jurisdictional tariffs. The filed rates doctrine was also applied to reverse a state commission's order disallowing FERC-approved *costs* in *Office of Public Counselor v. Indiana & Michigan Electric Co.*, 416 N.E. 2d 161 (Ind. App. 1981). In that case, the Indiana commission consolidated a retail electric utility and a wholly-owned nuclear subsidiary in order to set a single rate of return for the rolled-in assets. The intended result of the Indiana Commission was to eliminate the higher rate of return fixed for the subsidiary by FERC. In *Northern States Power Co. v. Minnesota Public Utilities*

[17] 16 U.S.C. §824a (Section 201(a), Federal Power Act). See, Senate Rep. No. 621, 74th Cong., 1st Sess., "Public Utility Act of 1935", p. 18.

Commission, 344 N.W. 2d 374 (Minn. 1983); *cert. denied* 104 S.Ct. 3546 (1984) and *Northern States Power Co. v. Hagen*, 314 N.W. 2d 32 (N.D. 1981), where affiliated utilities allocated canceled nuclear plant *costs* between themselves by means of a FERC-approved wholesale bulk power sales contract, it was held that the state commissions could not set the retail rates of these utilities so as to alter or interfere with the FERC's cost allocation. In *Eastern Edison Co. v. Department of Public Utilities*, 388 Mass. 292; 446 N. E. 2d 684 (1983), the state commission was likewise prohibited from disallowing abandoned nuclear plant *costs* which were included in the FERC-approved wholesale rates paid by the retail utility.

All of these cases are clearly distinguishable from the current case in that, in each case, the various state commissions attempted to disallow actual *costs* arising from and allocated by the FERC filed and approved rates. In the roll-in scenario of the current case, each and every item of *cost* arising from the NFA and the 1971 Agreement was recognized and allowed in the roll-in. Not a single *cost* was excluded. By the roll-in, all relevant *costs* of power arising from the various contracts were placed into the single system pot of *costs* and were allocated to the appropriate customer loads.

The North Carolina Supreme Court further rejected the Companies' reliance on the filed rate doctrine as stated in the foregoing cases by also noting that the Companies'

> ...arguments rest upon the faulty premise that FERC deemed both the NFA and the 1971 Apportionment Agreement to be fair and reasonable to Nantahala, when in fact it [FERC] expressly ruled that the latter agreement was "unfair" and refused to permit Nantahala to base its requested wholesale rate increase upon the costs incurred thereunder (313 N.C. at 693).

The NCUC's ~~roll-in~~ is far removed from the scope of the filed rate doctrine enunciated by the *Narragansett/Northern States* line of cases. In those cases, the FERC had approved, as fair and reasonable, the allocation of costs associated with the various rates or agreements. However, in the current case, the FERC expressly found that the 1971 Agreement was unfair.

The controlling facts of the present case are dramatically different from the facts in any of the *Narragansett/Northern States* line of cases.[18] As previously noted, Nantahala is not like Narragansett Power Company. The Nantahala/Tapoco single system is not like the Northern States Power Companies, Middle-South Utilities or the American Electric Power System. In none of the *Narragansett/Northern States* cases was the state commission compelled to pierce the corporate veil because of the parent's long history of domination and self-dealing for its own benefit.

1. *The FERC, In Setting Nantahala's Wholesale Rates, Did Not Follow The Filed Rate Doctrine.*

FERC is authorized to fix and establish just and reasonable wholesale rates under Section 205 of the Federal Power Act ("the Act"). FERC is no less bound by filed or approved power agreements than is a state commission in the latter's setting of retail rates. In litigation involving the Natural Gas Act,[19] this Court stated the reasons for this proposition as follows:

[18] The Appellees are aware of this Court's recent decision in *Transcontinental Gas Pipeline Corp. v. Oil and Gas Board, et al.*, ______ U.S. ______, Case No. 84-1076, 54 Law Week 4114 (January 22, 1986). While that case involved an interpretation of the Natural Gas Act and the Natural Gas Policy Act of 1978, the Natural Gas Act and the Federal Power Act are frequently used interchangeably, *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981). Nevertheless, the *Transcontinental* case adds nothing of substance to the filed rate doctrine of preemption previously discussed and is even further apart from the unique facts of this case than the *Narragansett/Northern States* line of cases. In contrast to this case, the Mississippi regulation (state action) in *Transcontinental* directly interfered with the federal scheme of national "regulation" of the supply, demand and price of high-cost gas by market forces, not FERC or state commission regulation. On its facts, the Court's holding in *Transcontinental* is clear, and clearly not applicable to the present case.

[19] 52 Stat. 823; 15 U.S.C. §717c(d).

> ...Except when the Commission permits a waiver, no regulated seller of natural gas may collect a rate other than the one filed with the Commission...(Citation omitted). These straight forward principles underlie the "filed rates doctrine", which forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority. ...
>
> * * *
>
> Not only do the courts lack authority to impose a different rate than the one approved by the Commission, but the Commission itself has no power to alter a rate retroactively. ...[20]

In its opinion 139-A, the FERC itself considered that it was bound by the filed rate doctrine. The FERC stated:

> ...It is true that we would be prohibited from relieving a company of an improvident contract unless we made a Section 206 finding that rates under the contract were so low as to adversely affect the public interest.... (A.J.S. p. 312a).

On December 2, 1980, the FERC, in Docket ER 81-19-000, accepted the 1971 Agreement as a jurisdictional rate schedule. In the Nantahala wholesale rate case, Docket Nos. ER 76-828 and EL 78-18, the ALJ did not render his initial decision until April 10, 1981. The Full Commission's Opinion 139 was not rendered until May 14, 1982 and Opinion 139-A was not rendered

[20] *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981). See, *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956). This argument necessarily assumes that the NFA and the 1971 Agreement establish the wholesale "rate" for a FERC-regulated entity to charge Nantahala for the power which Nantahala sells to its retail customers. As noted above, however, such are not the facts of this case, which further demonstrates the lack of a substantial preemption question here.

The retroactive ratemaking rule could also be applied to prevent FERC action in 1980 from approving an agreement retroactively to 1971 so as to interfere with a state regulatory commission's inquiry as to expenses, etc. in a previously filed retail rate case involving data arising out of a 1975 test year.

until September 30, 1982. Under the filed rate doctrine, if applicable to this case at all, FERC was obliged to abide by the terms of the 1971 Agreement, as filed on December 2, 1980. Yet, the FERC, ***without reforming that Agreement***, set Nantahala's wholesale rates upon a theoretical assignment of 44 million kwh more energy than was allocated to Nantahala under the Agreement!

The United States Court of Appeals in *Nantahala Power and Light Co. v. FERC*, 727 F.2d 1342, 1346 (4th Cir., 1984) upheld FERC's theoretical assignment by stating:

> ..Since Nantahala only received 360 million kilowatt hours under the 1971 Agreement, the [Federal Energy Regulatory] Commission reasoned that Nantahala had purchased from TVA 44 million kilowatt hours of energy more than it should have, and these excessive purchases should not have been reflected in Nantahala's rates.[21]

In other words, the scope of the filed rate doctrine is not so extensive as to prevent FERC action inconsistent with a filed rate in setting other wholesale rates.[22]

[21] The Fourth Circuit's opinion affirming FERC's decision was narrowly drawn and turned upon the FERC's broad ratemaking powers under §205 of the Act. As the Court stated: "While...this evidence does suggest a basis for the commission to order rolled-in costing, it does not compel the conclusion that the Commission must, as a matter of law, consolidate costs for ratemaking purposes. A decision to order roll-in is essentially a matter of Commission discretion..." *Nantahala Power and Light Co. v. FERC*, 727 F. 2d 1342, 1348 (4th Cir. 1984).

[22] We point out to the Court the difficulty Appellants and their supporting amici have in agreeing among themselves as to exactly what rate level the FERC established as the filed rate. (Compare Appellants' Brief, p. 24, where they seek the filed rate modified by 404 thousand mwh with FERC's Brief, pp. 9, 12, where it speaks of the rate filed with FERC in 1980).

2. *The FERC Did Not Assign Costs For Retail Ratemaking Purposes, Nor Did Its Action Allocate Power Between North Carolina And Tennessee.*

As earlier noted, the NFA was merely a power transformation agreement between Alcoa, Nantahala and Tapoco with TVA, whereby most of Nantahala''s hydroelectric generation and all of Tapoco's hydroelectric generation was, at the instant of production, turned over to TVA. TVA delivered return power entitlements of a type and quantum negotiated by Alcoa to suit its manufacturing operations but not the variable needs of a public load. The NFA was silent as to how the TVA return power was to be divided; instead, such division was left up to all three Alcoa companies. In fact, the NFA treated Nantahala and Tapoco as a combined system. If that agreement fixed costs, which is denied, it certainly did not allocate costs. The 1971 Agreement between Nantahala and Tapoco was a formal division, as between them (with Tapoco standing in Alcoa's shoes), of the power returned by TVA under the NFA.[23]

Neither of the two Agreements fixed or allocated, as between Nantahala and Tapoco, either the costs, revenues, capital requirements, money flow, rates or any other matter of a financial nature. All financial matters remained within the personal domain of each company, subject to Alcoa's ultimate control. Only the 1971 Agreement (which FERC found to be unreasonable and declined to follow) ever purported to assign or allocate power and energy.[24]

[23]Originally, the TVA return power entitlements had been divided by a 1963 Agreement between Alcoa, not Tapoco, and Nantahala which was much more favorable to Nantahala (See Appellees' Motion to Dismiss, pp. 9-10, items 16-18).

[24]It should be noted here that the NCUC's Order found Tapoco to be a North Carolina public utility with service responsibilities in North Carolina. Both Tapoco's state and federal licenses to operate the "Tallassee Project" required Tapoco to make certain power available to serve Nantahala and its customers. See Appellees' Motion to Dismiss, pp. 6, 7, Item 10; A.J.S. p. 25a.

In 1980, in Docket No. ER 81-19-000, when FERC accepted Tapoco's filing of the 1971 Agreement, it did absolutely nothing to fix or allocate either Nantahala's or Tapoco's stand-alone costs, revenues, capital requirements, money flow or any matter of a financial nature. The 1971 Agreement remained exactly what it had been before filing; namely, a power allocation or division as between Nantahala and Tapoco (Alcoa).

In Docket Nos. ER 76-828 and EL 78-18, the FERC examined the NFA and 1971 Agreement, but again it took no action to modify either Agreement so as to affect costs. Indeed, in Opinions 139 and 139-A, the FERC expressly disallowed the wholesale customers'' request to modify the Agreements pursuant to the FERC''s authority to do so under Section 206 of the Federal Power Act (A.J.S. pp. 281a, 311a.). Thus, the two Agreements remained exactly as they had always been.

The FERC found the 1971 Agreement to be unfair and unreasonable for wholesale ratemaking purposes (A.J.S. pp. 290a, 293a, 295a, 296a). More importantly, FERC also found that any wholesale rate flowing from the agreement, "...does not constitute a just and reasonable rate." (A.J.S. p. 312a).

Furthermore, FERC found that, by the 1971 Agreement, Nantahala and Tapoco did not sell power to each other. In Opinion 139, the FERC explicitly held that Nantahala and Tapoco "...unlike the companies in the Southern Systems... they do not exchange energy with each other...." (A.J.S. 292a). Without an exchange of power, there can be no sale.

Appellants' argument (stated as a fact) that the 1971 Agreement assigned power as between North Carolina and Tennessee, is also incorrect. The 1971 Agreement expressly allocates power only as between Nantahala and Tapoco, not as between states. Tapoco is not just a public utility with facilities and one customer in Tennessee, it is also a North Carolina public utility (A.J.S., p. 175a) with generating facilities in North Carolina (R.p. 79), holding a North Carolina Certificate of Convenience and Necessity with an obligation to serve the public (R.p. 88). Furthermore, Tapoco is an integral part of the Nantahala/Tapoco unified single elec-

tric public utility system which serves a public load in North Carolina. The 1971 Agreement does not even begin to purport to allocate power as between North Carolina and Tennessee.

3. *The NCUC Is Not Required To Follow FERC'S Ratemaking Methodologies.*

Appellants contend that the filed rate doctrine is so broad as to require a state commission to blindly follow FERC's ratemaking techniques. Thus, the Appellants hypothesize, because FERC specifically declined to pierce the corporate veil, declined to use the roll-in ratemaking methodology, declined to find that Nantahala and Tapoco comprise a single electric system, and declined to find that Tapoco is a North Carolina public utility, the NCUC could not make contrary findings. This is not a correct statement of ratemaking law.

Courts have repeatedly recognized that Federal and State regulatory commissions can adopt different ratemaking methodologies. *Mid-Tex Electric Cooperative, Inc. v. FERC, supra.* In *Public Systems v. FERC*, 709 F.2d 73, 84 (D.C. 1983), a FERC case dealing with tax allowances for rate setting, the Court said:

> There are many differences between the principles the state and federal commissions may utilize in setting wholesale rates. A given state may treat rate of return, *cost allocation*, rate base valuation, and normalization differently than the FERC (Emphasis supplied).[25]

Upon the appeal of FERC Opinions 139 and 139-A, in *Nantahala Power and Light Co. v. FERC, supra* 727 F. 2d at 1351, the Fourth Circuit Court stated:

[25]See also 16 U.S.C. §825(a). States can adopt different systems of accounts and depreciation schedules.

> Nantahala argues that the Commission's refusal to acknowledge a finding of fact of the North Carolina Utilities Commission that Nantahala had not recovered all costs of its wartime facilities and its placing the burden of proof on this issue upon Nantahala constituted reversible error....The North Carolina Utility Commission's approval (in 1975) of Nantahala's restatement of depreciation is clearly not binding on the FERC. Its decision was based on its assessment of the evidence. The Commission is clearly entitled to make its own assessment of the evidence before it.

In Opinion 139, the FERC also declined to follow the NCUC's finding that Tapoco was a North Carolina public utility stating:

> We note that subsequent to the hearings and briefing of this case, but prior to the initial decision, the North Carolina Utilities Commission issued a decision finding that Tapoco is a public utility under North Carolina law. However, the definition of "public utility" in North Carolina is peculiar to that state and not determinative of the issues to be decided here (A.J.S. p. 293a, footnote 21).

Of even greater significance is the fact that in Opinion 139-A, the FERC expressly acknowledged that the NCUC, applying State criteria, could validly require roll-in:

> We recognize that the North Carolina Utilities Commission (NCUC), based on a similar record, reached a different conclusion concerning rolled-in costing. However, the question of whether to treat various entities as an integrated system for ratemaking purposes is not a purely factual question, but also rests on criteria which each ratemaking authority may deem relevant (A.J.S. p. 305a).[26]

[26]The suggestion of the Solicitor General in his brief (p. 19, footnote 12) that the quoted language from Opinion 139-A was no more than a "casual remark"

Keeping in mind that the roll-in is a cost allocation technique, FERC's recognition of the NCUC's independence was correct and in line with the quoted language of *Public Systems v. FERC, supra*, that states are free to use their own cost allocation methodology.

B. The Filed Rate Doctrine Permits States To Determine Whether FERC-Approved Costs Are To Be Borne By Stockholders Or By Ratepayers.

A line of developing cases holds that, even if FERC has allocated a particular cost to a particular state or local utility, a state commission retains the right to determine whether such FERC-allocated cost, even though reasonable as between the wholesale utility and the retail utility, should be borne by the retail utility's ratepayers or by its stockholders. Not only may the state commission choose whether to pass such costs on to the retail ratepayers or to impose such costs on the shareholder(s) of the retail utility, it may determine the timing or the incidence of such costs.

The essence of this developing rule is aptly expressed in *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696, 699 (N.H. 1985), wherein it is observed:

> The PUC correctly determined under federal preemption principles that FERC approval of a wholesale rate precludes the PUC from questioning the *reasonableness of that charge*. However, it

(Footnote Con't)

by FERC, clearly conflicts with the context in which FERC made this ruling. In the FERC proceeding, Appellees had lodged the NCUC opinion at FERC and had argued that FERC should follow the NCUC single-system, roll-in determination. The ALJ declined to do so ("To remedy this situation, it is not necessary to pierce the corporate veil..." A.J.S. p. 275a). In affirming the ALJ on this point, FERC explicitly acknowledged the NCUC's right to reach a different conclusion based on "...criteria which [the NCUC] may deem relevant." (A.J.S. p. 305a).

> does not follow *automatically* that the PUC must find that power costs incurred under a wholesale rate are *necessarily* a *reasonable expense for the retailer*. ...(Emphasis supplied.)

Similarly, in *Public Service Co. of Colorado v. Public Utilities Comm. of Colorado*, 644 P.2d 933 (Colo., 1982), the Colorado Supreme Court reviewed an order of the Colorado PUC holding that FERC-approved costs of participation in the Gas Research Institute ("GRI") need not be passed through automatically to consumers. The Court concluded that the Colorado PUC had the authority to scrutinize such costs in a general retail rate case ". . . to balance the interests of utility investors and the ultimate consumers in arriving at a just and reasonable rate. . ." (644 P.2d, at 944) and affirmed the PUC.

Washington Gas Light Co. v. Public Service Comm. of the District of Columbia, 452 A.2d 375 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983) is similar. The Court reversed the D.C. Commission, however, because it found that the Commission's decision, regarding the flow-through of GRI expenses into retail rates, was based on the preempted conclusion that the wholesale increase was unreasonable, not on the permissible conclusion that a portion of such increase should not be passed along to the ratepayers in retail rates.

In the *Sinclair* case, *supra*, Connecticut Valley Electric Company ("Connecticut Valley") filed a general retail rate increase, based upon an increase in the wholesale rates which it paid to its power supplier, Central Vermont Public Service Corporation ("Central Vermont"). Connecticut Valley was a wholly-owned subsidiary of Central Vermont. Pursuant to a unilateral settlement agreement proposed by Central Vermont, FERC approved the wholesale rates charged by Central Vermont to Connecticut Valley. Such rates included a pass-through of Central Vermont's cost of two abandoned nuclear plants. Inclusion of these costs in Connecticut Valley's retail rates was challenged by the consumers on the basis of New Hampshire's "anti-CWIP" statute. The New Hampshire PUC held that it was required to automatically flow 100% of the settlement agreement rate into retail rates

The New Hampshire Supreme Court reversed, holding that, while the preemption (filed rate) doctrine precluded the PUC from disapproving the wholesale rate (despite the state's anti-CWIP statute), the PUC was free to inquire into the reasonableness of Connecticut Valley's purchases from Central Vermont, in light of other purchase options available. The case was remanded to the PUC to make this inquiry. The Court observed:

> The central question before the PUC in a retail rate case such as this is whether costs incurred under a wholesale rate, which has been approved as being a just and reasonable *charge* by the wholesaler, are just and reasonable *operating expenses* of the retail utility .... The PUC never reached this question (Emphasis supplied by the Court). *Sinclair, supra*, 498 A.2d 696, 699.

Accord, Pike County Light and Power Co. v. Pennsylvania Public Utility Commission, 77 Pa. Commw. Ct. 268, 465 A.2d 735 (1983).

There is a similarity between the NCUC's roll-in and the Colorado and New Hampshire cases if Nantahala were assumed to be a "stand-alone" utility. Viewed this way, the NCUC merely determined that some of Nantahala's so-called "stand-alone" costs were improper, with respect to retail ratepayers, and that such costs should be borne by the stockholders for whose benefit they were incurred.

Following a discussion of the above line of cases, the North Carolina Supreme Court approved the principle of shifting costs to the stockholder, that had not been incurred for the ratepayers' benefit, using this language:

> ...the Commission determined that one of the most fundamental of the concealed benefits flowing to Alcoa under the NFA was the trading away of hydroelectric capacity suitable for serving a public load, at a time of sustained growth in that load, in return for entitlements structured to be of far more value for aluminum smelting than for public service.

> Accordingly, the Commission determined that to the extent that Alcoa had caused Nantahala to trade capacity and energy suitable and usable for serving its public load, the costs associated with that trade-off would be borne by Alcoa and not by the retail ratepayers who lost the benefit of these resources and facilities of Nantahala through intercorporate transactions over which they had no control. This determination lies well within the sphere of state regulatory authority delineated in the *Narragansett-Northern States* line of cases relied upon by the companies in support of their preemption arguments (313 N.C., *supra* at p. 701).

Fundamental to such a cost shift in the current case are the circumstances of corporate abuse present between Nantahala and its parent, Alcoa.[27] The facts found below demonstrate that the historical development of the Alcoa Power System, including Nantahala and Tapoco, is unique in the electric power industry and cannot properly be compared to other, traditional electric utilities.[28]

Any argument by Appellants that this recent line of developing cases and the resultant shifting of cost responsibility to the stockholder are inappropriate here, on grounds that the various

[27]The NCUC stated in its opinion: "The Commission must conclude that Alcoa has so dominated these transactions and agreements affecting its wholly-owned subsidiary Nantahala that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interests of its public utility customers in North Carolina."; and "...Alcoa's dominance over its wholly-owned subsidiaries Nantahala and Tapoco during the course of the New Fontana negotiations has resulted in substantial benefits to Alcoa and significant detriment to the customers of Nantahala." (A.J.S. p. 233a).

[28]Alcoa tried to dispose of Nantahala's distribution system (and, thus, its load responsibility in North Carolina), by a sale of Nantahala's distribution system, but not any of Nantahala's major hydrogeneration resources, to Duke Power Company. The low cost hydropower from Nantahala's remaining generation system would have then been 100% available to Alcoa. Alcoa was prevented from such abandonment of its public load responsibility by a decision of the North Carolina Supreme Court. *Utilities Commission v. Membership Corporation*, 260 N.C. 59; 131 S.E. 2d 865 (1963).

commissions in the cited cases merely diminished profitability, whereas, in this case, the roll-in resulted in actual losses to Nantahala, is invalid. Nantahala is protected from any loss by the requirement that Alcoa make refunds.

In a later Nantahala retail case, recently remanded to the NCUC for further consideration, the North Carolina Supreme Court said of the Alcoa refund obligation:

> In its two previous orders implementing a roll-in ratemaking methodology, the Commission has not hesitated to place financial responsibility upon Alcoa for any portion of Nantahala's refund obligation which Nantahala is itself unable to pay while continuing to render adequate service to its customers. The relief ordered by the Commission, and affirmed by this Court, in the two prior rate cases is essentially the same relief sought by the intervenors in this case. There is no principal distinction between a refund financed by Alcoa to rate payers on the basis of excessive rates charged by Nantahala over a historic period, and a periodic payment by Alcoa to Nantahala for any current or future revenue shortages on Nantahala's books which may result from prospective rolled-in rates. Both forms of relief are merely anciliary to the establishment of a just and reasonable rate schedule as approved by the Commission for Nantahala. *Utilities Commission v. Edmisten*, 314 N.C. 122, 161; 333 S.E. 2d 453 (1985).

II.

THE NCUC'S USE OF THE ROLL-IN METHODOLOGY IN SETTING NANTAHALA'S NORTH CAROLINA RETAIL RATES IS NOT BARRED BY THE COMMERCE CLAUSE OF THE UNITED STATES' CONSTITUTION.

A. The Roll-In Is Outside Of The NEPCO Prohibitions.

Appellants contend that the roll-in grants an unconstitutional preference to Nantahala's North Carolina customers over Tapoco's Tennessee customer (Alcoa) in violation of the Commerce Clause of the United States Constitution (Art. I, §8, Cl. 3), as interpreted by this Court in *New England Power Co. v. New Hampshire*, 455 U.S. 331, (1982), hereafter "NEPCO".

Appellees fully recognize that NEPCO lays down a proper interpretation of the Commerce Clause in holding that a state utilities commission cannot give its citizens a preferential or exclusive right to the hydroelectric energy (or any other natural resource) produced in its state, and that the grant of such a preference or exclusive right places a direct and substantial burden on interstate commerce.

Clearly, a power preference has not been created by the roll-in. First, the roll-in did not, in any manner, deal with power and did not allocate Nantahala any power that it did not receive under the NFA and the 1971 Agreement. Rather than power, the roll-in allocated costs. Since the roll-in is based on the fact that Nantahala and Tapoco comprise a single electric public utility system, the roll-in merely allocated a fair percentage of the total single system's costs to Nantahala's retail customers. *This procedure was used only for purposes of setting Nantahala's retail rates.* The roll-in did not go beyond the NCUC's exclusive retail ratemaking functions, so as to allocate some of Tapoco's power to Nantahala, nor did it attempt to reform either the NFA or the 1971 Agreement. In addition, the roll-in does not mandate or affect the rate by which Tapoco sells power to Alcoa.

In NEPCO, the New Hampshire Commission attempted to insulate its protectionist order by implementing an accounting technique whereby the hydroelectric generation could actually flow out-of-state, but costs were to be calculated as if the power did not flow out-of-state. Methodology aside, however, the New Hampshire Commission enforced a state statute whose sole pur-

pose was to restrict the flow of local power generation and prevent it from flowing out-of-state. The applicable North Carolina statutes contain no such restriction, either as written or as applied by the NCUC.

This Court described the protectionist action of the New Hampshire Commission with this language:

> ...The order of the New Hampshire Commission, prohibiting New England Power from selling its hydroelectric Energy outside the State of New Hampshire, is precisely the sort of protectionist regulation that the Commerce Clause declares off-limits to the states. The Commission has made clear that its order is designed to gain an economic advantage for New Hampshire citizens at the expense of New England Power's customers in neighboring states. (455 U.S. at 339)

There is an enormous between the protectionist action of the New Hampshire Commission, which, for all practical purposes, blocked hydroelectric power from flowing out-of-state, and the action of the NCUC in determining that the properties and plants of Nantahala and Tapoco constitute a single electric public utility system and allocating to Nantahala's retail load its proper share of the total costs of that single system. New Hampshire's act was intended to bar the flow of power out of state, while the NCUC's act was simply to set just and reasonable rates for the North Carolina retail customers of a single electric public utility system operating in more than one state. The roll-in is not a technique by which the NCUC has attempted to "lock the door" to keep Nantahala's power from flowing out-of-state or to "grab" some of Tapoco's power generation for the exclusive benefit of North Carolina retail ratepayers. To the contrary, the roll-in is no more than a traditional cost allocation methodology applied to a single utility company, operating in more than one state, with both retail and wholesale loads. As a consequence, the NEPCO doctrine does not fit the facts of the present case.

If applicable at all, NEPCO approves rather than forbids the NCUC's roll-in methodology. That is to say, Alcoa and its allies (particularly the State of Tennessee) seek a protectionist order which would be NEPCO in reverse. They seek a result which requires that *all* not merely some) of Tapoco's power from its North Carolina facilities at Cheoah and Santeetlah be exported to Tennessee, while, at the same time, requiring that *none* of Tapoco's power from its Tennessee facilities at Chilhowee and Calderwood be allowed to leave Tennessee. It is Alcoa and its allies, not the Appellees, who are arguing in favor of economic protectionism.

To support their protectionist argument, the Appellants rely heavily on a misstatement in the NCUC order that the North Carolina public load had a "first call on the total electric energy output of the combined system" (A.J.S., p. 183a). Appellees believe that the most cogent response to this argument is the analysis of the North Carolina Supreme Court:

> ...Nowhere does the Commission's discussion or application of the roll-in methodology actually implement a "first call" concept. The Commission has not granted North Carolina customers a preference to the economic benefits of hydroelectric energy generated in North Carolina at the expense of Alcoa in Tennessee, it merely eliminated from Nantahala's existing rate structure preferences and inequities which were effectuated in the past by basing Nantahala's rates on the fiction that it was a stand-alone company. This traditional exercise of its ratemaking authority is simply not proscribed by the rule established in NEPCO, or in other Commerce Clause cases (313 N.C. at 715; A.J.S., p. 103a).

B. Any Economic Benefit Which Indirectly Flows From The Roll-In Is Permissible Under The Bruce Church Doctrine.

Appellants contend that the roll-in methodology was designed or intended to gain an economic advantage for North Carolina, at the expense of Tennessee, which is an impermissible burden on interstate commerce. Alcoa argues that it, as a *customer* of Tapoco, is penalized and the State of Tennessee argues that, as a result, Alcoa will close its Tennessee Operations, resulting in economic chaos. Both arguments are invalid.

We first point out that, during the 1975 test year, Nantahala's entire public load for approximately 29,000 customers was slightly in excess of 450 million kwh (Nantahala generated in excess of 560 million kwh in 1975; 313 N. C. 614, p. 644; A.J.S., p. 32a). By contrast, during that same year the Alcoa, Tennessee plant consumed 3.15 billion kwh (1,365,499,000 kwh purchased from Tapoco and 1,784,833,000 kwh purchased from TVA; 313 N.C. 614, at p. 638; A.J.S., p. 26a). Thus the Alcoa, Tennessee plant alone consumed seven times the amount of power that all of Nantahala's 29,000 retail customers consumed. The Alcoa, Tennessee plant consumption would have served some 203,000 customers of the average size of Nantahala's 29,000 (See, A.J.S., p. 215a).

Appellees point out that Alcoa has informed its stockholders that the Alcoa, Tennessee plant is currently being modernized[29] and has also reported to the Securities and Exchange Commission that such modernization has "gained momentum."[30]

The above matters are pointed out to refute the Appellants' alleged, but unproven, agrument that the roll-in somehow gives North Carolina customers an economic advantage with respect to Alcoa as a customer of Tapoco. We have previously refuted that assumption by showing that the roll-in imposes a financial obligation on Alcoa solely because of its status as the dominating, North Carolina public utility parent of Nantahala, not because of its status as "Tennessee citizen" or "Tapoco customer". The roll-in allocates only average single system costs, including the average single system cost of power. No preferences are award-

[29]Alcoa, Annual Report, 1984 (March 8, 1985), pp. 1, 11-12, 13.

[30]Alcoa SEC Form 10K (fiscal year ended December 31, 1984; Commission File Number 1-3610), p. 21.

ed to or detriments imposed upon any customer (or class of customer) of the single system.

Despite the foregoing, Appellants contend that the "...NCUC order epitomizes the kind of state interference with interstate commerce that the Commerce Clause was intended to prevent." (Brief p. 34). In contrast to such assertion, and in complete answer thereto, Appellees cannot improve upon the language of the learned Justice Meyer, of the North Carolina Supreme Court, where he said (A.J.S. pp. 103a-105a):

> It is well settled in modern commerce clause jurisprudence that the existence of a commerce clause violation depends in any case, upon 'the nature of the state regulation involved, the objective of the state and the effect of the regulation upon the national interest in the commerce.' *Illinois Natural Gas Co. v. Central Illinois Pub. Serv. Co.*, 314 U.S. 498, 505, 86 L.Ed. 371, 376. The Supreme Court recently reformulated the basic test to be applied as follows: 'Where [a] statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. (Citation omitted.) If a legitimate local purpose if found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a less impact on interstate activities.' *Pike v. Bruce Church*, 397 U.S. 137, 142; 25 L.Ed.2d 174, 178 (1970).
>
> In *Arkansas Elec. Coop. Corp. v. Arkansas Public Serv. Comm'n*, 461 U.S. 375, 76 L.Ed.2d 1, the Court applied the Bruce Church test to the question of whether state public service commission regulation of wholesale electric rates charg-

ed by a rural power cooperative to its member retail distributors was forbidden by the Commerce Clause of the United States Constitution. The Court upheld such "even-handed" regulation, reasoning that (l) economic protectionism is not implicated by the traditional rate making functions of the state public service commissions; (2) state regulation of wholesale rates charged by a rural power cooperative is well within the scope of 'legitimate local public interest,' particularly where the cooperative's basic operation consists of supplying power from generating facilities located within the state to member cooperatives, despite the fact that the cooperative is also tied into an interstate power grid; and (3) the effects on interstate commerce of state regulation of wholesale rates the cooperative charges its members are only incidental, so that the burden imposed on such commerce is not clearly excessive in relation to the putative local benefits.

In passing, the *Arkansas Electric* Court observed that despite the fact that most retail utilities receive a portion of the power they sell from out-of-state, "[T]he national fabric does not seem to have been seriously disturbed by leaving regulation of retail utility rates largely to the States. Similarly, it is true that regulation of the prices AECC [the cooperative] charges to its members may have some effect on the price structure of the interstate grid of which AECC is a part. But, again, we find it difficult to distinguish AECC in this respect from most relatively large utilities which sell power both directly to the public and to other utilities.

The NCUC's decision addresses matters of strong, legitimate local interest and purpose. The roll-in rates charged by Nantahala to its retail customers, and any conceivable impact thereof on Tapoco, Alcoa or TVA, could only have a *de minimis* or inciden-

tal effect on the price structure of the interstate grid of which Nantahala is a part. Any such incidental effect is clearly not excessive in relation to the substantial local interest in the NCUC's establishment of just and reasonable electric rates for Nantahala's North Carolina retail customers. If the roll-in did, somehow, touch upon interstate commerce, which is denied, the intrusion served a legitimate local public interest with only indirect and negligible effects on such commerce. Accordingly, *Bruce Church* allows such action.

CONCLUSION

Application of the specific and unique facts of this case to the federal preemption (filed rate) doctrine and to the Commerce Clause of the United States Constitution establishes that the roll-in applied by the NCUC does not encroach upon either FERC's exclusive jurisdiction over interstate power flows and wholesale electric rates or upon interstate commerce. Not only is the NCUC action outside of the preemption doctrine, it is a part of the NCUC's proper and lawful ratemaking responsibility to determine fair and reasonable retail intrastate rates.

Over 30 years ago, Justice Barnhill of the North Carolina Supreme Court (concurring) in *Utilities Commission v. Mead Corp.*, 238 N.C. 451, 465-468; 79 S.E.2d 290 (1953) correctly described the Nantahala/Alcoa relationship this way:

> ...If they (the NCUC) will only cut through the form to the substance, they will find just another hydroelectric power producing agency of Alcoa, retailing just enough of its production - less than 20% - to permit it to pose as a quasi-public corporation with the right to use the water power resources of this State, exercise the power of eminent domain, and enjoy the other monopolistic privileges accorded a public utility while it was, in fact, created and exists primarily to serve its master which seeks and must have low-cost hydroelectric power.

* * *

> ...Seldom indeed is a situation such as the one disclosed by this record brought to light in the course of litigation or otherwise. I am certain its parallel does not exist in this State.

Alcoa's flagrant manipulation of its power-producing subsidiaries, described by Justice Barnhill, continues to this day. It is this manipulation which has necessitated the NCUC's order and the roll-in methodology utilized by the Commission in setting fair and reasonable retail rates.

Accordingly, the decisions of the NCUC and the North Carolina Supreme Court are well founded and should be affirmed.

Respectfully submitted, this 21st day of February, 1986.

LACY H. THORNBURG
ATTORNEY GENERAL
OF NORTH CAROLINA

Richard L. Griffin
Assistant Attorney General
N.C. Department of Justice
Suite 207
Hayes & Hobson Building
20 South Spruce Street
Asheville, N.C. 28801
(704) 258-6083

Attorneys for: Using and Consuming Public

THE PUBLIC STAFF
N.C. UTILITIES COMMISSION

Robert Gruber,
Executive Director
James D. Little, Staff Attorney
Post Office Box 29520
Raleigh, N.C. 27626-0520
(919) 733-6110

Attorney for: Using and Consuming Public

CRISP, DAVIS, SCHWENTKER PAGE & CURRIN

William T. Crisp
Counsel of Record
Robert F. Page
320 South Salisbury Street
Post Office Box 751
Raleigh, North Carolina 27602
(919) 833-2556

Attorneys for: Henry J. Truett; Cherokee, Graham and Jackson Counties: Towns of Andrews, Bryson City, Dillsboro Robbinsville and Sylva; Swain County Board of County Commissioners; and the Tribal Council of the Eastern Band of Cherokee Indians

APPENDIX

APPENDIX

NORTH CAROLINA GENERAL STATUTES

§62-3. Definitions.

(23) c. The term "public utility" shall include all persons affiliated through stock ownership with a public utility doing business in this State as parent corporation or subsidiary corporation as defined in G.S. 55-2 to such an extent that the Commission shall find that such affiliation has an effect on the rates or service of such public utility.

§62-133. How rates fixed.

(b) In fixing such rates, the Commission shall:

(1) Ascertain the reasonable original cost of the public utility's property used and useful, or to be used and useful within a reasonable time after the test period, in providing the service rendered to the public within the State, less that portion of the cost which has been consumed by previous use recovered by depreciation expense plus the reasonable original cost of investment in plant under construction (construction work in progress). In ascertaining the cost of the public utility's property, construction work in progress as of the effective date of this subsection shall be excluded until such plant comes into service but reasonable and prudent expenditures for construction work in progress after the effective date of this subsection may be included, to the extent the Commission considers such inclusion in the public interest and necessary to the financial stability of the utility in question, subject to the provisions of subparagraph (b)(4a) of this section.

(2) Estimate such public utility's revenue under the present and proposed rates.

(3) Ascertain such public utility's reasonable operating expenses, including actual investment currently consumed through reasonable actual depreciation.

(4) Fix such rate of return on the cost of the property ascertained pursuant to subdivision (1) as will enable the public utility by sound management to produce a fair return for its shareholders, considering changing economic conditions and other factors, as they then exist, to maintain its facilities and services in accordance with the reasonable requirements of its customers in the territory covered by its franchise, and to compete in the market for capital funds on terms which are reasonable and which are fair to its customers and to its existing investors.

(4a) Require each public utility to discontinue capitalization of the composite carrying cost of capital funds used to finance construction (allowance for funds) on the construction work in progress included in its rate based upon the effective date of the first and each subsequent general rate order issued with respect to it after the effective date of this subsection; allowance for funds may be capitalized with respect to expenditures for construction work in progress not included in the utility's property upon which the rates were fixed. In determining net operating income for return, the Commission shall not include any capitalized allowance for funds used during construction on the construction work in progress included in the utility's rate base.

(5) Fix such rates to be charged by the public utility as will earn in addition to reasonable operating expenses ascertained pursuant to subdivision (3) of this subsection the rate of return fixed pursuant to subdivisions (4) and (4a) on the cost of the public utility's property ascertained pursuant to subdivision (1).

(20)

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA ex rel.
UTILITIES COMMISSION; LACY H.
THORNBURG, Attorney General,
et al.,

Appellees.

On Appeal from the Supreme Court of North Carolina

APPELLANTS' REPLY BRIEF

REX E. LEE*
DAVID W. CARPENTER
SIDLEY & AUSTIN
1722 Eye St., N.W.
Washington, D.C. 20006
(202) 429-4000
Counsel for Appellants

Of Counsel:
RONALD D. JONES
DAVID R. POE
M. REAMY ANCARROW
LEBOEUF, LAMB, LEIBY
& MACRAE

EDWARD S. FINLEY, JR.
WILLIAM D. JOHNSON
GRADY L. SHIELDS
HUNTON & WILLIAMS

Counsel of Record

24 PP

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES:

STATUTES:

OTHER AUTHORITIES:

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA ex rel.
UTILITIES COMMISSION; LACY H.
THORNBURG, Attorney General,
et al.,

Appellees.

On Appeal from the Supreme Court of North Carolina

APPELLANTS' REPLY BRIEF[1]

Introduction

No amount of rhetoric or obfuscation can alter the one fact that controls this case. As the North Carolina Supreme Court stated, the NCUC here set retail electric rates in North Carolina by itself "allocat[ing]" wholesale costs of producing and distributing electricity "between the public load customers in North Carolina and the industrial load customer (Alcoa) in Tennessee." Appendix to Jurisdictional Statement ("App") 16a. The NCUC excluded from Nantahala's North Carolina retail rates some $45 million in wholesale costs that were "associated with" and "actually incurred" by Nantahala as a result of the pertinent FERC rate schedule, and the NCUC "effectively allocated [these costs] for rate making purposes to the systems' industrial customer, Alcoa, on whose behalf the [NCUC] determined they were

[1]The Statement of Appellants Required by Rule 28.1 appears at p. ii of the Jurisdictional Statement.

incurred." App. 69a-70a. This is precisely what the Federal Power Act and the Commerce Clause forbid. States have no jurisdiction to make these interstate wholesale cost allocations, but must include the precise wholesale costs that result from the pertinent FERC rate schedules (or FERC decisions modifying them) in the local utility's retail revenue requirements and retail rates.

The most striking feature of the briefs of appellees and the two *amici* who support them is that none disputes this central point. No one disputes that Congress enacted the Federal Power Act to confer exclusive jurisdiction over interstate wholesale cost allocations on FERC, as a neutral federal agency. Appellants' Br. pp. 21-22. No one disputes that Congress, like this Court before it, recognized that it would profoundly burden interstate commerce if each interested State could make its own separate determination of how interstate wholesale costs of producing electricity should be divided among customers in different States. *Id.* pp. 30-31. No one disputes that this would lead to the incessant litigation that Congress sought to prevent (*id.* pp. 31-32), and that each affected State would also seek to adopt allocations that would advance its selfish interests at the expense of neighboring States. *Id.* p. 30. It is this kind of parochialism that led to a constitutional convention 200 years ago.

Nonetheless, these three North Carolina entities offer a series of arguments in defense of what North Carolina has done. None has any substance.

I. North Carolina's Actions Are Preempted By The Federal Power Act.

A. There Are No "Unique Facts" That Could Permit Departure From Established Principles.

Initially, appellees "fully accept" (p. 15) the principle that any state action which interferes, directly or indirectly, with FERC's exclusive jurisdiction to determine the proper interstate allocations of wholesale costs is preempted.[2] Specifically, they acknowledge that this Court's "filed-rate doctrine" protects FERC's exclusive jurisdiction over bulk power supply arrangements[3] and that state supreme courts and now federal courts have uniformly implemented this doctrine in *Narragansett*,[4] *Northern States*,[5] and other decisions.[6] While recognizing the broad latitude that States enjoy in determining the other components of retail revenue requirements and retail rates,[7] this doctrine requires States, in setting retail rates, to do what the NCUC refused to do here: include the power acquisition costs that result from the pertinent FERC rate schedule in retail revenue requirements and retail rates. If a State believes that the FERC rate schedule is unfair to its residents, the state commission's exclusive remedy is to seek modification of the rate schedule in a properly instituted FERC proceeding (and make provisions in the retail rate order for a refund to the extent such modifications are thereafter ordered by FERC). *Narragansett*, *supra*, 381 A.2d at 1363; *Northern*

[2]*Maryland* v. *Louisiana*, 451 U.S. 725, 749-50 (1981); see *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Board*, 54 U.S.L.W. 4114 (Jan. 22, 1986).

[3]*Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951).

[4]*Narranganset Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

[5]*Northern States Power Co.* v. *Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn.), *cert. denied*, 104 S. Ct. 3546 (1984); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981).

[6]See Appellants' Br. 25-29. Since appellants' brief was filed, lower federal courts have acknowledged this *Narragansett-Northern States* doctrine in *New Orleans Public Service, Inc.* v. *New Orleans*, 782 F.2d 1236, 1241-42 (5th Cir. 1986); *Appalachian Power Co.* v. *Public Service Commission of West Virginia*, No. 2: 85-0098 (S.D. W.Va. Feb. 14, 1986), and *Arkansas Power & Light Co.* v. *Missouri Public Service Commission*, No. 86-4067-CV-C-5 (W.D. Mo. March 10, 1986).

[7]For example, state commissions determine the value of the retail rate base, set the allowed rate of return, and determine whether expenses outside FERC's jurisdiction should be included in retail revenue requirements.

States, supra, 314 N.W. 2d at 38. FERC, and FERC alone, can authorize departures from the bulk power supply arrangements filed by the utility and their associated costs. When FERC does so—as it did here[8]—this establishes a new filed rate that equally binds the States.

While accepting this principle, the North Carolina entities made three separate arguments that it is inapplicable here due to the "unique facts" of this case.

Alcoa's Alleged Domination. Appellees' primary claim, made in arguments scattered throughout their brief (*e.g.*, pp. 10, 13–14, 17, 27 & n. 27, 36), is that FERC should not have exclusive jurisdiction over cost allocation questions here because of the appellees' *allegation* that Alcoa, as the sole shareholder of Nantahala and Tapoco, dominated these utilities. Specifically, they claim (*e.g.*, p. 17) that Alcoa is guilty of self dealing, that it generally preferred its interests over those of the North Carolina public load over a 40 year period, and that those preferences are reflected in the NFA and the 1971 Apportionment Agreement that comprise Nantahala FERC Rate Schedule No. 1.

But this allegation cannot deprive FERC of jurisdiction. To the contrary, as the Fourth Circuit held when it rejected this very domination argument in the parallel federal proceedings,[9] these

[8]Appellees are simply incorrect in arguing (p. 17) that FERC is "no less bound" by the filed-rate doctrine "than is a state commission" and that the fact that FERC can modify utility-filed rate schedules means that States can ignore them altogether in setting retail rates. The statutory scheme requires FERC to investigate a utility's contractual bulk power supply arrangements and reject those that are unreasonable. This is the exercise of the regulatory function that Congress assigned FERC and FERC alone. In contrast, it would nullify the congressional plan if a State could simply refuse to give effect to a FERC rate schedule (or decision modifying it) in setting retail rates.

[9]The Fourth Circuit held that the conflict between the interests of Nantahala's shareholder (Alcoa) and its customers is no different in kind than that present in any case FERC decides. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342, 1347–48 (4th Cir. 1984). The Court

(Footnote continued on following page)

are precisely the kind of claims that must be decided by an impartial federal tribunal rather than a self-interested State when, as here, interstate wholesale cost allocations are involved. This is vividly demonstrated by the fact that the North Carolina Attorney General (on behalf of Nantahala's retail customers) here vigorously litigated its domination claims before FERC in the earlier complaint proceeding under Section 206 of the Federal Power Act. There, FERC flatly rejected this claim and agreed with the earlier conclusions of even the NCUC that the challenged arrangements are fair to Nantahala's retail customers.[10] Moreover, contrary to appellees' assertions that no court has disagreed with their position (p. 2), FERC's findings were affirmed,

(Footnote continued from previous page)

further held that FERC can, and did, "scrutinize . . . the fairness of all transactions allocating resources between Tapoco and Nantahala" to assure that "Alcoa's needs" and the "different, and often conflicting, needs of Nantahala" were reasonably accommodated. *Id.* at 1348.

[10]Prior to the order on review, the NCUC found that the NFA and 1971 Apportionment Agreements were fair and reasonable to Nantahala ratepayers on at least two separate occasions. See *North Carolina ex rel. Utils. Commn* v. *Edmisten*, 291 N.C. 575, 232 S.E.2d 177, 179 (1977) (describing NCUC finding); *North Carolina ex rel. Utils. Commn* v. *Edmisten*, 299 N.C. 432, 263 S.E.2d 583 (1980) (same); Tr. Vol. 6, pp. 25–27. It is presumably for this reason that the NCUC did not itself initially challenge these agreements in the FERC proceedings under Sections 205 and 206 of the Federal Power Act.

In this regard, appellees' repeated allegations of a "long history of domination" and improper conduct by Alcoa from the 1930s to 1960s are ironic. There is abundant evidence that Alcoa's development of hydroelectric facilities in North Carolina conferred enormous benefits on Nantahala ratepayers (Tr. Vol. 7, pp. 38–39; Ex. JML-4), and these are facts which even the North Carolina Court of Appeals unanimously accepted in this case:

> "[A] good argument could be made that the best friend Nantahala's customers have is Alcoa. It financed the building of large hydroelectric facilities at a time when Nantahala could not have justified constructing them for its public customers. Nantahala's customers have had for many years the benefit of these facilities built at 1941 costs."

(Footnote continued on following page)

and appellees' arguments rejected, by the Fourth Circuit. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342, 1346–49 (4th Cir. 1984).

In short, appellees' factual claims were presented to FERC, and to the Fourth Circuit. And they lost. They lost before FERC and they lost before the Fourth Circuit—both of which are neutral tribunals with no interest in favoring one State over another in allocating low-cost power. To permit North Carolina or any other State to relitigate these matters, disregard FERC's findings, and thereby appropriate more low-cost hydroelectric power than allocated by FERC would thoroughly subvert the uniform, orderly, and evenhanded scheme that Congress established.[11]

(Footnote continued from previous page)
App. 164a. Thus, Nantahala's retail rates (as filed with the NCUC) have been found to be the lowest in North Carolina, and they are among the lowest in the nation. See United States Department of Energy, Energy Information Administration, *Typical Electric Bills: January 1, 1985*, pp. 17, 125 (1985); Tr. Vol. 14, p. 63; Tr. Vol. 9, p. 12.

[11]This is especially so because Nantahala's retail customers made *identical* domination and "roll-in" claims in both the FERC complaint proceeding (tried in 1980) and the subsequent NCUC proceeding (tried in 1981). Indeed, the customers made these identical claims through the same witness (David Springs) and virtually the same documents in each proceeding. *Compare* FERC Docket No. 78-18, Complaint, *Highlands* v. *Alcoa*, pp. 13–19 (April 24, 1978); *id.*, Tr. 1947-2031, 2217-2362, & App. 279a, 287a-288a, *with* App. 179a-221a & Tr. Vols. 15, 16 & 17. The only material difference between the two proceedings is that the neutral agency, FERC, rejected the North Carolina entities' claims, whereas the self-interested agency, the NCUC, accepted them.

The NCUC's actions are ironic because even it does not contend that it has the power directly to determine the reasonableness of wholesale costs. Yet it has attempted to reach that identical result by reassessing and rejecting the factual premises on which the FERC determination rests. Either way, the NCUC cannot disregard FERC's wholesale cost allocations for the only purpose that really matters: recovery from Nantahala customers.

Scope Of FERC Regulation. Next, the North Carolina parties and *amici* argue that the filed-rate doctrine cannot apply here because, in their view, FERC has not allocated power acquisition costs between the North Carolina public load and the Tennessee manufacturing load. Appellees' Br. pp. 20-21. Instead, appellees claim that FERC regulates and allocates only power supplies.

This argument misperceives what FERC does and ignores what both FERC and the North Carolina Supreme Court have said. Because all electricity is fungible and is intermingled in the vast interstate grid, FERC does not allocate power supplies as such under Sections 205 and 206 of the Federal Power Act; *any* FERC power allocation is necessarily an allocation of costs. In all events, the NFA and 1971 Apportionment Agreement explicitly determine costs; indeed, that is the only purpose of the 1971 Agreement.[12] Thus, when FERC ruled on the Complaint in which Nantahala's customers challenged these agreements, FERC's very first sentence states that the "issue . . . is the appropriate allocation of *costs*" between the North Carolina and Tennessee customers. App. 285a (emphasis added). The North Carolina Supreme Court agrees. It acknowledges that "costs associated with" the FERC-regulated agreements were "actually incurred" by Nantahala, noting that the NCUC reallocated these costs to the "nonjurisdictional Alcoa industrial load" in Tennessee. App. 40a, 69a-70a; see App. 15a, 16a.

---

[12]Nantahala's power acquisition costs are determined by three agreements: the NFA (which determined the amount of low-cost entitlements to be shared by Nantahala and Tapoco), the 1971 Apportionment Agreement (which established Nantahala's share of those low-cost TVA entitlements), and the 1971 Nantahala contract with TVA (which establishes the rates Nantahala pays for supplemental power purchased from TVA). Because Nantahala's energy and capacity entitlements are *credits* against its TVA purchases, there is no question that the NFA and 1971 Agreement directly determined Nantahala's power acquisition costs—as FERC repeatedly found. App. 281a, 298a, & 309a. See also *Nantahala Power & Light Co.* v. *FERC*, *supra*, 727 F.2d at 1345. Indeed, it is because the NFA and 1971 Apportionment Agreement are wholesale sales and "contracts . . . affect[ing] . . . rates" that they are rate schedules under Section 205 of the Federal Power Act. App. 253a, 263a-66a.

Indeed, even appellees elsewhere admit that FERC's regulation of the agreements determined Nantahala's power acquisition costs, for they acknowledge (p. 16) the "cost[s] arising from the NFA and the 1971 Agreement." Here, they claim that there was no violation of the filed-rate doctrine because, in their view, the costs were not "excluded" in setting Nantahala's retail rates, but "each and every item of cost . . . was recognized and allowed." *Id.* It is not clear how appellees can make such a claim. No one disputes—or can dispute—that the NCUC excluded $2 million of the costs that Nantahala incurred as a result of these agreements from its retail revenue requirements in the 1975 test year, producing a $45 million refund liability. See Appellants' Br. p. 15; App. 234a. Semantics or labels cannot change the fact that this is precisely what the Federal Power Act and the filed-rate doctrine forbid.[13]

Similarly, appellees' repeated assertions (*e.g.*, p. 14) that the issue in this case is whether the Federal Power Act preempts States from "setting . . . retail rates using a roll-in" of the costs of affiliated utilities are simply incorrect. There may well be circumstances in which States may "roll-in" affiliated firms to determine those retail ratemaking costs that are within the state's jurisdiction to determine (*e.g.*, the local utility's administrative costs or costs of capital). See p. 3 n.7, *supra.* But that is not the issue in this case. What a State manifestly cannot do is what North Carolina did here: use a "roll-in" or any other label to defeat FERC's

[13]Appellees' arguments (*e.g.*, pp. 5 & 10) that the NCUC's actions are supported by its finding that Tapoco is a North Carolina public utility are erroneous for the same reason. As FERC found, Tapoco's public utility status under North Carolina law is irrelevant to the cost allocation issue, which is within FERC's exclusive jurisdiction. App. 292a-293a & n.21. Further, the North Carolina finding rests on the fact that the NCUC issued Tapoco a certificate of convenience and necessity at the time that the NCUC, in 1955, purported to *approve* the transfer to Tapoco of two of the hydroelectric plants that are used to serve Alcoa in Tennessee (see App. 272a-73a), so the certificate could not represent a dedication of Tapoco facilities to serve Nantahala's customers even if the NCUC had jurisdiction to so order—which it does not.

regulation of the allocations of wholesale costs between customers in different States. This proposition has been consistently recognized by FERC and state supreme courts alike.[14]

FERC's Cost Allocations. Finally, appellees do not dispute that FERC Opinion No. 139 rejected their factual claims. See p. 6, n.11, *supra.* FERC found that Nantahala's fair share of the low-cost TVA entitlements power was no more than 54.3 mW of capacity and 404 thousand mWh of energy and that there was no basis for shifting any other costs from Nantahala to Tapoco. Yet appellees claim that this FERC Opinion somehow authorized the NCUC to set retail rates on the assumptions (1) that Nantahala receives 92.7 mW of low-cost entitlements capacity (increasing to 100.1 mW and beyond in future years) or almost twice what FERC approved, (2) that Nantahala receives 433 thousand mWh of low-cost energy entitlements (increasing to 460 thousand mWh and beyond), and (3) that Tapoco pays for 75% of the supplemental high-cost TVA power that Nantahala purchases to serve its North Carolina customers. These arguments are astonishing.

Appellees first assert (p. 9) that FERC Opinion No. 139 determined only the rates that Nantahala could charge its three wholesale customers and did not "allocate the cost of power for purposes of retail ratemaking." While this would not support North Carolina's actions even if true (*see* p. 12, *infra*), the assertion is

[14]See Appellants' Br. 33 n.46. In this regard, appellants are baffled by North Carolina's reliance (Appellees' Br. p. 23) on the statement in FERC Opinion No. 139A that "the question of whether to treat various entities as an integrated system for ratemaking purposes is not purely a factual question, but also rests on criteria which each ratemaking authority may deem relevant." App. 305a. Here, FERC was simply rejecting the North Carolina customers' assertion that the fact that the NCUC had adopted a roll-in methodology could mean that FERC was required to do the same. FERC did not even address the question of North Carolina's jurisdiction to make a different interstate wholesale cost allocation than prescribed by FERC's regulation. Moreover, FERC could not relinquish its exclusive jurisdiction over these interstate wholesale cost allocations in any event.

false and contradicted by the North Carolina Attorney General's own undisputed actions.

In Opinion 139, FERC had before it *both* a rate case involving Nantahala's three wholesale customers and a complaint case in which Nantahala's customers charged that its supply arrangements had unfairly inflated Nantahala's costs of obtaining power "for resale" to its entire North Carolina public load, wholesale and retail.[15] Each case required FERC to determine Nantahala's fair share of the low-cost TVA entitlements, and all recognized that the FERC decision in the consolidated proceeding would determine one component of Nantahala's operating expenses for retail as well as wholesale ratemaking purposes. It was for this reason that the North Carolina Attorney General intervened in the proceedings on behalf of Nantahala's retail customers and unsuccessfully claimed that FERC should order the very cost reallocations that the NCUC subsequently adopted. Indeed, the North Carolina Attorney General appealed FERC's decision in FERC Opinion No. 139 *solely* on the ground that it was error not to grant greater relief in the complaint case. *Edmisten* v. *FERC*, No. 82-1948 (4th Cir.); see 727 F.2d 1342. For these reasons, appellees' claim that FERC's decision was limited to the three wholesale customers is spurious.

Appellees' remaining arguments all proceed from the fact that FERC did not find that the NFA and 1971 Apportionment Agreement were fair to Nantahala's customers in each and every respect, but required one adjustment to assure Nantahala's customers their fair share of the energy entitlements: that Nantahala

[15]Complaint, *Town of Highlands* v. *Alcoa*, FERC Docket No. EL 78-18, pp. 13-19. In addition, when FERC earlier accepted the 1971 Apportionment Agreement for filing under Section 205 of the Federal Power Act, FERC stated that the "reasonableness of the apportionment arrangement shall be subject to the outcome" of the wholesale rate case and the complaint proceeding. App. 266a. FERC's cost allocation determinations in Opinion 139 thus governed a third proceeding as well.

be treated as receiving 404 thousand mWh, rather than 360 thousand mWh. This adjustment simply establishes a new "filed rate" that also binds the NCUC. Yet appellees claim that the fact that FERC made one adjustment to the provisions of the contracts as originally filed means that the NCUC can radically depart from the arrangements that FERC expressly approved and thereafter ignore FERC jurisdiction altogether. This is a *non sequitur*.

The claim depends entirely on the North Carolina entities' assertions (Appellees' Br. 10, Highlands' Br. p. 9-10) that FERC did not modify Nantahala FERC Rate Schedule No. 1 in Opinion 139. But these assertions are false and could not support North Carolina's position even if they were true.

The entire basis for the argument that the pertinent rate schedule was not modified is that FERC did not reform the underlying contracts; instead, it protected the customers' interests by prescribing that Nantahala would be regulated "as if" it had received the additional 44 thousand mWh of energy required to give it its "fair percentage." See Appellees' Br. p. 29. However, the fact that an underlying contract is not reformed cannot establish that the rate schedule was not modified.[16] Thus, the only

[16]This Court has long recognized that FERC's authority to regulate "the service in which the producer engages is distinct from the contract[s]" that govern the utility's relationships with others and that FERC has the authority to regulate such service on a different basis than contained in any underlying private contract, without reforming it. *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137, 152-53 (1960); *see Pennsylvania Water & Power Co.* v. *FPC*, 343 U.S. 414, 422 (1952). Here, moreover, FERC stated that it rejected the Staff proposal to reform the contract *only* because it was not necessary "to remedy this situation" in that (1) the alternative under which Nantahala is regulated "as if" it received an additional 44 thousand mWh of energy entitlements would fully protect ratepayer interests (by reducing Nantahala's reasonable power acquisition costs and rates accordingly) and (2) there did not appear to be any reason or basis for reforming contractual arrangements between Nantahala and TVA or Tapoco directly. App. 280a-281a, 305a, 308a-309a. Thus, the failure to reform the agreement has no significance.

possible basis for appellees' argument is that Opinion 139 did not expressly state that Nantahala would be treated as having received the additional energy for all purposes, retail as well as wholesale. But this is the necessary meaning of the FERC order if, as appellees assert, FERC found that the 1971 Agreement's energy allocation is unfair. Section 206 of the Federal Power Act provides that where, as here, FERC finds that a practice or contract affecting rates is "unjust," FERC "shall determine the just and reasonable . . . practice. . . . to be *thereafter observed and in force.*" App. 257a. (emphasis added) Indeed, as appellees recognize (Br. p. 19), FERC could not have validly entered the order it did with respect to Nantahala's three wholesale customers (and the Fourth Circuit could not have affirmed it) unless Nantahala FERC Wholesale Rate Schedule No. 1 had been so modified. Significantly, FERC itself has construed Opinion 139 to modify FERC Nantahala Rate Schedule No. 1,[17] and the appellees' contrary argument is nothing more than an assertion that FERC does not understand its own order.

Further, even if FERC had not modified the rate schedule, this omission could not help appellees. The only alternative interpretation of the FERC decision is that no change was made to the rate schedule as originally filed. In that event, the filed-rate doctrine would require North Carolina to give effect to the contracts as written, and Nantahala's retail rates would have to be set on the basis that it receives the 54.3 mW of low-cost capacity entitlements and the 360 (rather than 404) thousand mWh of energy entitlements provided by the 1971 Apportionment Agreement. That would require increases in Nantahala's authorized retail rates beyond even those that appellants advocate.

In all events, this Court need not attempt to resolve any ambiguities in FERC Opinion No. 139 to decide this case. In 1981, the NCUC's obligation under the Federal Power Act and the

[17]Brief for the United States and The Federal Energy Regulatory Commission As Amici Curiae Supporting Appellants (January, 1986) ("FERC Amicus Br."), p. 5.

Commerce Clause was to include all the costs incurred as a result of Nantahala FERC Rate Schedule No. 1 in Nantahala's retail revenue requirements and rates (subject, in NCUC's discretion, to a future refund only to the extent that the rate schedule was modified in the then-pending FERC proceedings). Thus, this Court can and should reverse on the ground that the NCUC violated this federal requirement. If the NCUC or other affected parties really believe that FERC Opinion No. 139 suffers from a lack of clarity on this issue or any other, North Carolina can, on remand, file an appropriate application for clarification with FERC under Section 306 of the Federal Power Act. This is their exclusive remedy.

B. There Is No Basis For Creating The Urged "Exception" To The Filed-Rate Doctrine.

Appellees also argue (p. 24) that there should be an "exception" to the principle that FERC has exclusive jurisdiction over interstate wholesale cost allocation issues. That exception would permit States to determine whether "FERC-allocated costs" should be "borne by the retail utilities ratepayers or its shareholders" and to refuse to give effect to FERC rate schedules (and the underlying wholesale cost allocations) in setting retail rates.

This is simply a claim that States should be allowed to interfere with "FERC's authority to regulate the proper determination of the allocation of costs" (*contra, Maryland* v. *Lousiana*, 451 U.S. 725, 749-50 (1981)) and to recreate the same state of affairs that the Federal Power Act—and the Commerce Clause itself—were adopted to prevent. The facts of this case vividly demonstrate the point. It is undisputed that the NCUC here adopted an interstate cost allocation methodology which would, if also adopted by Tennessee, permit recovery of only 70% of the wholesale production and distribution costs through wholesale and retail rates. Appellants' Br. 30; Tr. Vol. 15, p. 119. It is the risks of such short-

falls and the resulting economic strife among States that it was the purpose of the Federal Power Act and the Commerce Clause to end. See Appellant's Br. 29-32.

Nor is there a "developing" line of state cases that adopts this view. Compare Appellees Br. p. 24. To the contrary, it has been the *state* supreme courts that have developed the body of case law that prevents the kind of economic balkanization that North Carolina advocates.[18] These States uniformly recognize that it is in the interest of all if FERC alone referees wholesale cost allocation disputes among them. There is only one exception. It is North Carolina.

In this respect, appellees' (pp. 24-26) and amicus Highlands' (pp. 18-20) reliance on *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985), and *Pike County Light & Power Co.* v. *Pennsylvania Public Utilities Commission*, 77 Pa. Commonw. Ct. 268, 465 A.2d 735 (1983), is misplaced. Those courts held only that there are circumstances in which States can exclude from retail rates power acquisition costs incurred under one FERC rate schedule on the ground that the retail utility could have obtained its power at a lower cost from a different wholesale supplier under a *different* FERC rate schedule. Neither decision permits a State to make its own determination of how interstate wholesale costs should be allocated between different States.[19] In any event, while there is some question whether either decision withstands analysis,[20] this Court need not address that issue. *Sinclair* and *Pike County* have no applicability here and cannot justify what North Carolina has done.

[18]Appellees' reliance (p. 25) on *Public Service Co.* v. *Public Utils. Commn. of Colorado*, 644 P.2d 933 (Colo. 1982), and *Washington Gas Light Co.* v. *Public Service Commn. of District of Columbia*, 452 A.2d 375 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983), is misplaced. In each, the state supreme court held that the state commission was required to do precisely what the NCUC refused to do here: include all costs incurred under the pertinent FERC rate schedule in retail revenue requirements. The fact that each court held (as did the court in *Narragansett*) that increases in FERC rates need not automatically be passed through to retail ratepayers merely reflects that federal law fixes only one component of retail revenue requirements—the reasonable power acquisition expenses—and that a State can permissibly find savings in other aspects of the utility's business that offset increased purchased power expenses. See Appellants' Br. pp. 26 n.36, 28 n.40.

These decisions recognize that those costs that flow from particular wholesale transactions must be included in retail revenue requirements if FERC has "expressly or impliedly" determined the power supply arrangements that are fair to a utility's ratepayers. *Sinclair*, 498 A.2d at 704. Here, FERC investigated and rejected claims that Nantahala and its retail customers should have obtained more than 54.3 mW of capacity and 404 thousand mWh of energy from the pool of low-cost hydroelectric power that resulted from Tapoco's and Nantahala's facilities. Indeed, the issue whether this arrangement was fair and reasonable to Nantahala's retail customers was at the heart of the FERC complaint proceeding. See p. 6 n.11. Thus, *Sinclair* and *Pike* each

[19]Under *Sinclair* and *Pike County*, the interstate cost allocations that underlie *each* FERC wholesale rate schedule remain the exclusive province of FERC. *Pike* and *Sinclair* merely allow States to set retail rates in some circumstances as if the local utility had acquired its power under one FERC schedule rather than another.

[20]The issue posed by the *Pike County* and *Sinclair* holdings is whether the Federal Power Act preempts states from deciding issues which FERC *could have* decided (because they came within its jurisdiction) but did not. The amicus briefs filed by the Edison Electric Institute and the New England Electric System (p. 15 n. 9) argue that the *Sinclair* and *Pike County* holdings on this issue are inconsistent with the Federal Power Act and with general preemption principles. *Cf* Appellants' Br. p. 28-29 n.41. Whatever the merits of those arguments, they need not be reached in this case. Here, the issue is not one that FERC merely could have decided if it had elected to do so. Rather, the only issue is which allocation of the NFA entitlements is fair to Nantahala's customers, and FERC decided that issue. *Sinclair* and *Pike* squarely recognize that there is preemption where FERC has faced the issue and made a decision, for they hold that the authority of state regulators reaches only "those matters not resolved by the FERC." *Sinclair*, 498 A.2d at 704; see *Pike*, 465 A.2d at 737-38.

prohibit North Carolina from adopting a different interstate cost allocation in setting retail rates.

II. North Carolina's Actions Violate The Commerce Clause.

Finally, the North Carolina entities have also offered no substantial response to appellants' argument that the Comm rce Clause would, by its own force, prohibit North Carolina's actions even if the Federal Power Act did not preempt them. The North Carolina entities do not dispute that the Federal Power Act provides the "same substantive protections" with respect to the interstate wholesale cost allocations at issue as does North Carolina law and that there is no local interest that could justify North Carolina's actions if they substantially interfere with Commerce Clause values. *Edgar* v. *MITE Corp.*, 457 U.S. 624, 644-45 (1982). Thus, the North Carolina entities defend the NCUC order solely by contending that it does not affect interstate commerce in any material way. They assert that all the NCUC has done is regulate retail transactions within North Carolina and that, in any event, any extraterritorial regulation is "evenhanded" and has, at most, a *de minimis* effect on interstate commerce. Appellees' Br. pp. 28-35.

However, the attempt to disavow the interstate character of the NCUC's action is squarely refuted by the terms of the NCUC's order. As the North Carolina Supreme Court stated, the NCUC set retail rates by reallocating power acquisition costs between two States and "effectively allocated" $45 million in costs "to the industrial load customer (Alcoa) in Tennessee," ordering Alcoa to "refund" these amounts to the North Carolina retail customers.[21]

[21]North Carolina's actions will constitute impermissible extraterritorial regulation and blatant economic protectionism, regardless of how the refund order is characterized. However, the North Carolina Supreme Court statements, and the entire history of the case, refute the repeated assertions (*e.g.*, Appellees' Br. pp. 3, 32) that the $45 million refund obligation was imposed on Alcoa as the shareholder of Nantahala, not as

(Footnote continued on following page)

App. 16a, 69a-70a. Indeed, because the NCUC's methodology requires that it "extend its control into the interstate area" by treating a "local utility and a distinct out-of-state entity as a single unit for cost and ratemaking purposes" (FERC Amicus Br. p. 19 n.13), any claim that interstate commerce is unaffected is self-refuting. As FERC states:

> "The state is inconsistently attempting both to create an interstate entity for purposes of establishing costs, and denying its interstate character for purposes of asserting its ratemaking authority. But North Carolina's attempt is equivalent to creating an inter-utility bulk power transaction, to obtain Tapoco's power for Nantahala and its North Carolina customers. This the state utility commission is forbidden to do, both by the Federal Power Act and this Court's pre-Act Commerce Clause cases." FERC Amicus Br. p. 19 n.13.

The claims (pp. 30-32) that North Carolina has acted "evenhandedly" and applied a "traditional cost allocation methodology" stand in even starker contrast with its actions. Appellees can make this argument only by ignoring that North Carolina has not only allocated to itself radically greater amounts of the pool of low-cost power than FERC had determined to be North Carolina's fair share, but also has allocated itself *ever-increasing* amounts. Appellees do not dispute, and cannot dispute, that their own witness testified that this methodology would give the North Carolina public load the benefits of all the low-cost North Carolina and Tennessee hydroelectric power by 1989, with none for the "Tennessee (Alcoa) manufacturing load." Appellants' Br. p. 36; Tr. Vol. 17, pp. 38-39. Appellees do not dispute, moreover, that North Carolina's share will continue to increase whenever its

(Footnote continued from previous page)

the Tennessee customer. The *sole* predicate for North Carolina's actions was its finding that the economic benefits of North Carolina resources had been unfairly transferred to Alcoa's Tennessee smelting facility and that the $45 million in costs were "actually incurred" to benefit "the systems' industrial customer, Alcoa" in Tennessee. App. 69a-70a; see *id.* 15a, 16a, 40a.

needs do, whether or not Tennessee's needs increase at the same (or a faster) rate. See Appellants' Br. 11-14. Nor do appellees dispute that this is precisely the kind of protectionism that the Commerce Clause is designed to prevent.

Indeed, Appellants' Brief demonstrated at length (pp. 11-14) that these economic preferences resulted from three separate but interrelated aspects of the NCUC's methodology, each of which is flatly inconsistent with FERC's explicit findings. Yet Appellees' Brief makes no attempt to explain or defend any of the three. Bald assertions of "evenhandedness" cannot alter the preferential character of the NCUC's interstate allocation. The Commerce Clause thus prohibits North Carolina from setting retail electric rates on the basis of a different allocation of the low-cost TVA entitlements than FERC approved.

CONCLUSION

For the reasons stated in this brief and appellants' opening brief, the decision and judgment of the North Carolina Supreme Court should be reversed.

Respectfully submitted,

REX E. LEE*
DAVID W. CARPENTER
SIDLEY & AUSTIN
1722 Eye St., N.W.
Washington, D.C. 20006
(202) 429-4000

Counsel for Appellants

Of Counsel:

RONALD D. JONES
DAVID R. POE
M. REAMY ANCARROW
LEBOEUF, LAMB, LEIBY & MACRAE

EDWARD S. FINLEY, JR.
WILLIAM D. JOHNSON
GRADY L. SHIELDS
HUNTON & WILLIAMS

Dated: April 3, 1986

**Counsel of Record*

13

No. 85-568

In the Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY, ET AL., APPELLANTS

v.

UTILITIES COMMISSION OF NORTH CAROLINA, ET AL.

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE SUPPORTING APPELLANTS

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOANNE LEVEQUE
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

321

QUESTIONS PRESENTED

Under the Federal Power Act, 16 U.S.C. 791a *et seq.*, the Federal Energy Regulatory Commission has sole authority over transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce. The questions presented are:

1. Whether the North Carolina Utilities Commission acted in contravention of established preemption doctrine in failing to give effect in calculating the retail rates for local end-users in North Carolina to the costs and allocations contained in the federally regulated interstate wholesale transactions that preceded the final retail sale.

2. Whether the North Carolina Utilities Commission rate order at issue in this case is also invalid under the Commerce Clause because of the economic preferences it grants local consumers at the expense of interstate markets.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Cases—Continued: Page

Cases—Continued: Page

Constitution and statutes:

In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-568

NANTAHALA POWER AND LIGHT COMPANY, ET AL., APPELLANTS

v.

UTILITIES COMMISSION OF NORTH CAROLINA, ET AL.

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE SUPPORTING APPELLANTS

INTEREST OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Congress has charged the Federal Energy Regulatory Commission with the responsibility for administering the Federal Power Act, 16 U.S.C. 791a *et seq.*, including those provisions governing rates and charges for electric energy at wholesale in interstate commerce. 16 U.S.C. 824d, 824e. Accordingly, under the Federal Power Act, while the Commission does not

regulate retail rates to consumers, it does have exclusive authority to decide whether bulk wholesale power arrangements between utilities are just and reasonable. The North Carolina Utility Commission's reallocation of less expensive power between two utilities in this case, in order to reduce retail utility rates to North Carolina consumers at the expense of a customer in Tennessee, is inconsistent with the Commission's exercise of responsibility over such bulk power arrangements, and upsets the system that Congress established for regulation of electric rates in interstate commerce.

STATEMENT

A. Background And The Relevant Agreements.

As originally established, electric utilities tended to be local and self contained, and many still generate power through their own facilities. Nevertheless, today interconnections between different utilities permit the ready movement of bulk power from one part of the country to another over vast interstate grids. This national system encompasses a wide variety of formal interstate arrangements. Many of these arrangements are between independent companies, but frequently—as in this case—several companies operating under a common ownership participate with others in the arrangements for the interstate transfers of bulk power. See generally J. Pfeffer & W. Lindsay, The National Regulatory Research Institute, Ohio State University, *The Narragansett Doctrine: An Emerging Issue in Federal-State Electricity Regulation*, Occasional Paper No. 8 (Dec. 1984).

Nantahala Power and Light Company, an electric utility serving the public in North Carolina, is owned by Aluminum Company of America (Alcoa). Alcoa

also owns Tapoco, Inc., which exclusively serves Alcoa's aluminum operations in eastern Tennessee. Both operating companies own hydroelectric facilities along the Little Tennessee River, built many years ago with Alcoa financing and licensed by the Commission under Part I of the Federal Power Act (16 U.S.C. 797(e)). J.S. App. 18a-19a.

In the midst of these facilities is the large Fontana hydroelectric plant, built by the Tennessee Valley Authority in the early 1940s.[1] From the construction of Fontana until after the events relevant to this case, with very minor exceptions TVA directed the operation of all these facilities.[2] J.S. App. 19a-29a. During the relevant time period, TVA's operation of the facilities was pursuant to the New Fontana Agreement (NFA), signed in 1962, among TVA and Nantahala-Tapoco-Alcoa (J.S. App. 28a). That agreement provided that TVA would direct operations of Nantahala's and Tapoco's hydroelectric plants and take all the energy generated from them, which would vary according to stream flow conditions (J.S. App. 28a-29a, 286a). In return, certain specific entitlements to energy and power—but less than the total power generated by the Nantahala and Tapoco plants and taken by the TVA—were to be supplied to Nantahala and Tapoco-Alcoa by TVA (*ibid.*). The NFA itself, however, did not detail how much of these entitlements would go to each; these matters were spelled out in separate agreements. For purposes of this case, the relevant document is the 1971 Apportion-

---

[1] While Fontana and the Nantahala hydroelectric facilities are in North Carolina, the Tapoco facilities are in both North Carolina and Tennessee (J.S. App. 18a-19a).

[2] This permitted the most efficient operation of the total complex.

ment Agreement between Nantahala and Tapoco. J.S. App. 30a-31a, 286a-287a.

Both Nantahala and Alcoa bought power from TVA to meet their needs beyond the amounts they received as entitlements from TVA under the NFA, as provided for in the 1971 Apportionment Agreement (J.S. App. 287a).[3] However, this power purchased from TVA was more expensive—it cost about three times as much as entitlement power. Thus, the entitlement power received under the NFA, with costs based on the cost of running the Nantahala and Tapoco generating units, was less than 6 mils per kilowatt hour (kwh) (J.S. 6); the cost of power purchased from TVA with its higher expenses averaged about 19½ mils per kwh. J.S. App. 287a.[4]

B. The Decision Of The Commission.

In 1976 and 1978, the Commission[5] initiated proceedings based on a Nantahala rate filing and a complaint filed by one of its customers (J.S. App. 269a-270a). In that proceeding, the Commission examined the NFA and the 1971 Apportionment Agreement, which were filed as rate schedules. J.S. App. 283a-289a. After thorough consideration of these agree-

[3] Alcoa, unlike Nantahala's customers, made its own power purchasing arrangements directly with TVA (J.S. App. 66a).

[4] Nantahala's and Tapoco's generation is all old, low cost hydropower; TVA, as hydro sources were exhausted, has more recently had to add considerable capacity from more costly, nonhydro sources, and distribute these costs to its customers. J.S. App. 32a n.11.

[5] The term "Commission" herein refers to the Federal Power Commission prior to October 1, 1977, and to the Federal Energy Regulatory Commission thereafter. See 42 U.S.C. 7172(a), 7295.

ments and the claims of the parties, the Commission held that the NFA was "the result of arms' length bargaining" (J.S. App. 293a) and that it "indicates no intent on the part of any of the parties to ignore the needs of Nantahala's public service customers or deprive them of energy at just and reasonable rates." J.S. App. 295a. The Commission did decide, however, that adjustments were required in the 1971 Apportionment Agreement to give a somewhat bigger share of the entitlements from TVA to Nantahala, and decided how much that greater share would be. J.S. App. 295a-298a.

Based on that readjustment, the Commission established the rates that Nantahala could collect from its three wholesale customers in North Carolina. Once the division of entitlements was established, it followed that the remaining volumes of power required would be purchased from TVA under the contractually established rates. Rates to Nantahala's wholesale customers thus reflect the respective costs of its entitlements and its purchased power. J.S. App. 298a, 301a.[6]

Following appeals by Nantahala, by some of its customers and by the Attorney General of North Carolina, the court of appeals affirmed the Commission's decision in all respects. *Nantahala Power & Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984).

C. The Ruling Of The North Carolina Commission And The State Supreme Court.

The North Carolina Utilities Commission (NCUC) in its review of retail rates charged by Nantahala re-

[6] The Commission noted that "[t]he effect of this opinion is to provide entitlements to Nantahala which will result in just and reasonable rates to its wholesale customers" (J.S. App. 298a).

jected the NFA on the basis that it was unfair to Nantahala and did not result in just and reasonable rates (J.S. App. 15a, 32a, 70a-71a). It substituted an approach proposed by Nantahala's customers,[7] which would give Nantahala, and consequently the North Carolina retail customers, a larger share of the low cost entitlement power, and correspondingly reduce their need for more expensive purchases. Specifically, NCUC first calculated the available energy, which it defined to include the total energy available to TVA from the Nantahala and Tapoco facilities, rather than the smaller volumes of entitlements which Nantahala and Tapoco actually received from TVA for delivery to their customers (J.S. App. 68a-69a). NCUC then added to this figure the amount of power Nantahala bought from TVA and delivered to its customers; it did not include Alcoa's TVA purchases (*ibid.*). NCUC defined this overall amount as the "pool" of power. It next calculated how much power Nantahala needed to serve its customers, which amounted to about 25% of the pool (*ibid.*). NCUC then totalled the costs associated with generating power from both the Nantahala and Tapoco facilities and the cost of Nantahala's purchased power (but not Alcoa's). It applied the 25% figure to that amount to derive what Nantahala would be allowed to collect from its North Carolina retail rate payers.

This method of calculation resulted in a shift of more low cost power to Nantahala for its customer load than the FERC had allocated in its proceeding. As NCUC recognized, its method gave Nantahala "first call" on the electric energy output deemed available (J.S. App. 183a). This approach necessarily meant that while Nantahala's customers got an allocation based on their needs, Alcoa (Tapoco's customer) was left with only whatever residual low cost power remained after both Nantahala and TVA had taken their supplies of "available" power. At the same time, Alcoa was made responsible for the costs not only of all of its own TVA purchases, but 75% of Nantahala's as well (J.S. App. 69a-70a). Alcoa's share of the costs was further swollen by amounts attributable to the power that went to TVA and was not reflected in entitlements received in return. As the result of these NCUC rulings, the end users served by Nantahala received a substantial reduction in their retail rates.

[7] FERC had earlier rejected that approach when proposed by the wholesale customers (J.S. App. 288a-298a).

While the North Carolina Supreme Court recognized that NCUC's rulings raised "substantial questions under the federal constitution" concerning preemption and interference with interstate commerce (J.S. App. 12a-13a), it concluded that there was no constitutional infirmity and affirmed NCUC in all relevant respects (J.S. App. 12a, 72a-106a).

INTRODUCTION AND SUMMARY OF ARGUMENT

This case involves a classic dispute over the allocation of limited amounts of inexpensive power, and the costs associated with it, between customers of different companies in different states. A state, of course, has a legitimate interest in reducing the cost to its citizens of electric power, but its authority to effectuate that reduction is not unbounded; there are constitutional limitations that must be observed. As this Court recently explained in *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 377 (1983) (citations omitted):

> Maintaining the proper balance between federal and state authority in the regulation of electric and other energy utilities has long been a serious challenge to both judicial and congressional wisdom. On the one hand, the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States. * * * On the other hand, the production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests.

In this case there is a finite amount of cheap power and a pool of costs that must be absorbed by someone. The approach employed by NCUC would benefit the Nantahala customers in North Carolina by giving them more of the low cost entitlement power, and permitting them to absorb less of the overall costs associated with that power. However, it would have the concomitant effect of forcing additional costs on the other customer, Alcoa, located in Tennessee. This is precisely the type of dispute which should be resolved in a federal forum.

I. Under the Federal Power Act, Congress has established a federal regulatory authority to deal with what has long been properly viewed as a matter of inherently interstate concern—*i.e.*, the bulk power arrangements between utilities that have become so important in the electric utility industry. The Commission is empowered to review and, in appropriate circumstances, modify these arrangements. Although Congress explicitly provided a role for states and state utility commissions in the federal process, there can be no overlapping decisional authority. It is fun-

damentally at odds with the scheme Congress has established in the Power Act to permit state authorities to change the arrangements filed with or established by FERC in order to make them more favorable to their own citizens at the expense of operations in other states. Indeed, to allow such state determinations would be particularly inappropriate in the present context, because NCUC has sought to change the precise allocations established by the Commission in the course of its review of the interstate arrangements.

II. Viewed from a slightly different perspective, the North Carolina action here also violates the Commerce Clause because, like the situation reviewed by this Court in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982), the state's reallocation of the economic benefits resulting from the NFA parties' agreement constitutes impermissible protectionist regulation.

ARGUMENT

I. THE STATE'S ACTION HERE IS PREEMPTED BY THE FEDERAL POWER ACT

A. The Federal Commission's Authority To Establish Wholesale Rates Is Comprehensive.

In a series of cases from 1919 to 1927, this Court fashioned a constitutional line of demarcation between permissible and impermissible state regulation, holding that the Commerce Clause permitted the states to regulate retail sales but not wholesale sales in interstate commerce. If a utility sold to consumers and at the same time engaged in power transactions with other utilities, the state could regulate the former but not the latter. The reasoning was that:

> [T]he supplying of local consumers being "a local business," even though the gas be brought from another State, in which the local interest is paramount and the interference with interstate commerce, if any, indirect and of minor importance; but that in the sale of gas in wholesale quantities, not to consumers, but to distributing companies for resale to consumers, where the transportation, sale and delivery constitutes an unbroken chain, fundamentally interstate from beginning to end, "the paramount interest is not local but national, admitting of and requiring uniformity of regulation," which, "even though it be the uniformity of governmental nonaction, may be highly necessary to preserve equality of opportunity and treatment among the various communities and States concerned."

Public Utilities Commission v. *Attleboro Steam & Electric Co.*, 273 U.S. 83, 89 (1927) (quoting *Missouri* v. *Kansas Gas Co.*, 265 U.S. 298, 309-310 (1924)).

With the enactment of the Federal Power Act in 1935, Congress created a scheme of federal regulation under which the previously established commerce clause criteria were effectively subsumed by statutory preemption of the entire wholesale electric area. See, *e.g.*, *New England Power Co.*, 455 U.S. at 340: *Maryland* v. *Louisiana*, 451 U.S. 725, 750-751 (1981); *Arkansas Electric Cooperative Corp.*, 461 U.S. at 381. The federal scheme leaves no room either for direct state regulation of wholesale prices, or for state regulations that indirectly have the same result. *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84, 91 (1963).

In the Federal Power Act, Congress has established a comprehensive federal regulatory scheme to deal

with sensitive issues of apportionment of rights and obligations among interests in different states.[8] Unquestionably, a prime purpose of the Federal Power Act, like state regulatory laws, is to protect customers against overreaching by electric utilities. See *Gulf States Utilities Co.* v. *FPC*, 411 U.S. 747, 758 (1973). But the federal statute also reflects the judgment, embodied in the Commerce Clause, that there are situations where the broader perspective of the federal authority is necessary. Cf. *Edgar* v. *Mite Corp.*, 457 U.S. 624, 644 (1982).

The federal regulatory scheme recognizes the legitimacy of state interests in this area, and provides for the consideration of those interests in the Commission regulatory process. States and state commissions may file complaints about activities of licensees and public utilities subject to the Commission's jurisdiction (16 U.S.C. 825e) and their objections may ultimately result in Commission action declaring rates, practices and contracts unjust and unreasonable and establishing new ones (16 U.S.C. 824e(a), 824d(e)). The states may also seek review of Commission orders in the federal courts (16 U.S.C. 825*l*(b)). There is

---

[8] This case obviously involves such interests. On one side is North Carolina, which has decided that it should have a larger share of the low cost entitlement power for its consuming public. On the other side are the Tennessee interests —Alcoa, which is the Tennessee customer, supported in this Court by the State of Tennessee and by the United Steelworkers Union representing Alcoa's Tennessee employees. In addition, this Court has granted the Edison Electric Institute's motion to file a brief amicus curiae to explain the impact of the decision below on the interests of its members, investor-owned electric utility companies. This Court has long recognized that investors have a protectible interest in the establishment of just and reasonable rates. See note 11, *infra*.

no room in this scheme, however, for the states or state commissions to act inconsistently with Commission determinations with which they are dissatisfied.

In recognition of this comprehensive federal regulatory authority over wholesale rates, it is specifically settled that a rate filed with the Commission and within its jurisdiction, although subject to judicial review, cannot thereafter be challenged in another forum; only the Commission is empowered to order it changed. *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-252 (1951). The "filed rate" is reasonable as a matter of law and any effort by a state to disregard or reject it is impermissible. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 581-582 (1981). State courts have consistently affirmed that state regulatory commissions are prohibited from reevaluating the wholesale rates fixed by FERC and disallowing, for retail ratemaking purposes, those that the state commission finds to be unreasonable.[9]

---

[9] *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), cert. denied, 435 U.S. 972 (1978), is generally considered the leading case, although it in turn relied on earlier decisions in *City of Chicago* v. *Illinois Commerce Commission*, 13 Ill. 2d 607, 616, 150 N.E.2d 776, 780-781 (1958); *United Gas Corp.* v. *Mississippi Public Service Commission*, 240 Miss. 405, 442-444, 127 So. 2d 404, 420-421 (1961); and *Citizen Gas Users Association* v. *Public Utilities Commission*, 165 Ohio St. 536, 538, 138 N.E.2d 383, 384 (1956).

Numerous other courts have followed *Narragansett*. *E.g.*, *Eastern Edison Co.* v. *Department of Public Utilities*, 388 Mass. 292, 446 N.E.2d 684 (1983); *Office of the Public Counsellor* v. *Indiana & Michigan Electric Co.*, 416 N.E.2d 161, 164-165 (Ind. App. 1981); *Public Service Co.* v. *Public Utilities Commission*, 644 P.2d 933, 936-940 (Colo. 1982); *Appeal*

B. The State Cannot Validly Establish Retail Rates That Fail To Give Effect To Wholesale Costs Approved By The Commission.

While the North Carolina Supreme Court did not expressly reject the "filed rate" doctrine, in fact it ignored the Commission's filed rate as established in the wholesale rate proceeding. Thus, while the state court recognized that the Commission has exclusive jurisdiction over the wholesale power transactions and agreements among Nantahala, Tapoco, Alcoa and TVA (J.S. App. 72a), that court nonetheless substantially revamped those arrangements to suit parochial state interests.

To be sure, the North Carolina court has not in terms rejected any wholesale rates or modified any agreements filed with FERC (J.S. App. 76a). But what it has done amounts functionally to the same thing: It has affirmed the NCUC's disregard of FERC's allocations of the low cost power in favor of an allocation more favorable to local customers. The state decision thus approves precisely the intrusion into the federal regulatory jurisdiction that the Federal Power Act prohibits.

1. The court below unsuccessfully attempted to distinguish the case law applying the "filed rate" doctrine (see note 9, *supra*). *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), cert. denied, 435 U.S. 972 (1978), involved the cost of power that Narrangansett, a utility which served Rhode Island, brought from New England

---

of Sinclair Machine Products, Inc., 498 A.2d 696 (N.H. 1985); *Spence* v. *Smyth*, 686 P.2d 597 (Wyo. 1984); *Washington Gas Light Co.* v. *Public Service Commission*, 452 A.2d 375, 384-386 (D.C. App. 1982), cert. denied, 462 U.S. 1107 (1983).

Power Company, an affiliate serving Massachusetts. Since that was a wholesale transaction, the Commission regulated the rate, but the Rhode Island Public Utilities Commission (PUC) ruled that it could nevertheless prevent Narragansett from passing through to its customers any portion of that rate that the PUC found "strikingly" or "glaringly" unreasonable (119 R.I. at 563-564, 381 A.2d at 1361).

Relying upon the "filed rate" doctrine as developed by this Court in *Montana-Dakota*, 341 U.S. at 251-252, the Rhode Island Supreme Court held that the Federal Power Act had preempted the authority of PUC to investigate interstate prices. It found that the determination as to overreaching was exclusively for the federal commission to make, and if overreaching was found, it was exclusively up to the federal commission to make the necessary adjustments to remedy the situation. In short, the state court held that the wholesale rate fixed by the federal commission constituted an operating expense of Narragansett and must be so viewed by PUC. 119 R.I. at 566-567. 381 A.2d at 1362. Thus, while FERC does not establish retail rates, it does establish the reasonableness of purchased power costs.

Of course, purchased power costs are not the only costs an electric utility incurs. The *Narragansett* court accordingly noted that the state did not necessarily have to recognize changes in purchased power costs through a purchased power adjustment clause that provided for automatic rate increases or decreases based on changes in that one element, regardless of what was happening in other cost areas. Instead, *Narragansett* permitted PUC to consider changes in a general rate proceeding where all costs would be evaluated together. 119 R.I. at 568, 381

A.2d at 1363. What *Narragansett* does require, however, is that a utility's wholesale power costs (*i.e.*, "the filed rate") be recognized as "just and reasonable" operating expenses in the state retail ratemaking proceeding.[10] As the opinion summarized (*ibid.* (emphasis added: citation omitted)):

> The manner in which a fuel adjustment clause is treated is an administrative matter where there is broad latitude for the exercise of sound discretion. Therefore, we do not order the PUC to automatically adjust the retail rates in accordance with the purchased power cost adjustment clause. Rather, we remand the case to the PUC with the direction that no matter what method it adopts in considering Narragansett's proposed rate increase, *it must treat the* [*FERC*] *filed* [*rate*] * * * *as an actual operating expense.*

Similarly unfounded is the reliance of the court below (J.S. App. 83a-84a) on isolated language in a footnote in *Washington Gas Light Co.* v. *Public Service Commission*, 452 A.2d 375, 385 n.15 (D.C. App. 1982), suggesting that "determination of the extent to which wholesale costs shall be reflected in utility rates lies exclusively with local utility commissions." Since in the related text the *Washington Gas Light* court strongly reaffirms the *Narragansett* holding that "State and local commissions have no authority, therefore, to inquire into the reasonableness of wholesale rates, but *must allow them as reasonable operating expenses*" (452 A.2d at 385-386 (emphasis added)), the footnote statement cannot have the

[10] *Public Service Co.*, note 9, *supra*, similarly deals with the mechanics of the cost passthrough; it does not question the recovery of federally regulated rates as part of the expenses of a buying company.

broad meaning the court below attributed to it. Instead, it merely recognizes, as we explained above, that *Narragansett* does not require the automatic passthrough of all changes in wholesale rates without consideration of changes in other operating costs.[11]

2. The proper interplay of federal and state regulatory authority here is well illustrated by a recent series of cases involving Northern States Power. The *Narragansett* line of cases involves the first step in establishing utility rates—the calculation of the revenue requirement, or the money needed to recover reasonable expenses and capital costs. In contrast, this case, *Northern States Power Co.* v. *Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn. 1984), cert. denied, No. 83-1752 (June 18, 1984), and *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981), involve the second step in the process of establishing rates—designing rates so that revenues sufficient to meet the revenue requirement will be recovered from the totality of the customers served. At this stage, the question is not whether to disallow costs, but whether to assign them to another customer.

[11] *Narragansett* also recognized (119 R.I. at 568, 381 A.2d at 1363) that the failure to treat filed costs as operating expenses might result in confiscation of the utility's property. This Court has explained that no regulatory commission can set rates at a level that prevents the utility from recovering its reasonable operating expenses. Investors are entitled to demand rates sufficient to cover expenses and capital costs of the business, including a return to shareholders commensurate with returns on other businesses with similar risks. *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Cf. *Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U.S. 276, 289 (1923); *Bluefield Water Works* v. *Public Service Commission*, 262 U.S. 679, 690 (1923). This case does not, of course, involve any direct attempt by a local commission to establish confiscatory rates. NCUC does not want to disallow the costs at issue here, it simply wants to shift them to the out-of-state customer of the other utility (J.S. App. 86a). The effect, however, may be the same. See pages 18-19, *infra*.

Preemption principles must be considered at this stage too, as the *Northern States Power* cases demonstrate. Northern States Power has one company serving customers in Minnesota and the Dakotas and another serving those in Wisconsin. An interstate wholesale arrangement between the two companies provided that they would share all capacity and all costs, pursuant to a formula set forth in the Coordinating Agreement between them that was filed with the Commission. When shrinking demand projections for the system led to a decision to cancel a major facility that was to be located in Wisconsin and owned by the Wisconsin company, utility commissions in the other states objected to sharing in the costs caused by the cancellation, arguing that those costs should be born solely by the Wisconsin company. The FERC upheld application of the Coordinating Agreement to the situation (see *South Dakota Public Utilities Comm'n* v. *FERC*, 690 F.2d 674 (8th Cir. 1982)) and the Supreme Courts of Minnesota (*Northern States Power Co.* v. *Minnesota Public Utilities Commission*, *supra*) and North Dakota (*Northern States Power Co.* v. *Hagen*, *supra*) reversed the state utility commission determinations that the costs could not be reflected in their local retail rates.

Both state courts recognized (314 N.W. 2d at 35-38, 344 N.W. 2d at 381-382 n.17) that the *Narragansett* principle applied in this context as well; FERC's approval of the application of the Coordinating Agreement to this situation established the wholesale rate, and "the state utilities commission

is required to treat the allocated abandonment costs as expenses for power purchased in determining the retail rates" (344 N.W.2d at 382; accord, 314 N.W. 2d at 38). These rulings are entirely correct, and the same principle also governs here. If each state could decide for itself whether to follow the federal allocation decision, each would be likely to adopt the approach that would minimize the costs assigned to its own ratepayers—as NCUC did here. While each approach might, if considered in isolation, be reasonable, the result for utilities operating interstate and their investors would be a shortfall of unrecovered costs, due to the application of inconsistent approaches, each designed to minimize costs to a particular group. The very real possibility of such inconsistent regulatory determinations, threatening to leave extensive gaps of this sort, has led utilities to seek a single forum.[12] When operations are interstate

[12] Some inconsistencies are tolerated in the federal-state regulatory system established under the Federal Power Act. For example, in this case NCUC regulates Nantahala's rates for the part of its power that goes directly to North Carolina retail customers, while the Commission regulates the rates for the power sold to North Carolina wholesale customers. The two authorities may make different judgments about how the utility's costs (upon which rates are based) should be allocated between these two groups, which could leave Nantahala with either a revenue gap or an overcollection. Minor inconsistencies of this sort, involving the allocation of the costs of a single company among the customers of that company, are not likely, however, to have serious practical effects. This case, in contrast, involves a very different situation: it concerns the costs of the bulk power transactions upon which the company relies to obtain the power it sells to its customers, and the state's attempt to allocate a substantial part of those costs, not to other customers of that utility, but to customers of a separate entity. This attempt cannot prevail against the Commission's exclusive jurisdiction over the bulk power transactions involved; the Commission approved costs arising from these transactions must be recognized by state ratemaking authorities. In their Motion to Dismiss or Affirm (at 15-16), appellees rely on a casual remark of the Commission (J.S. App. 305a) that may have failed adequately to distinguish the separate considerations involved in these two types of situations.

in nature, the federal forum is provided by the Federal Power Act.[13]

3. The court below invokes another line of state court cases, permitting state commissions to inquire into available alternative power sources (J.S. App. 84a). See *Pike County Light & Power Co.* v. *Pennsylvania Public Utility Commission*, 77 Pa. Commonw. 268, 465 A.2d 735 (1983); *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985). But those cases simply stand for the proposition that

[13] A company with large retail operations in several states may minimize the effects of inconsistent state regulation by establishing a separate corporate entity in each state. But by doing this, the company subjects itself to the FERC ratemaking authority, to the extent there are power arrangements between them, rather than within a single corporation. The state cannot, as NCUC attempted here, extend its control into the interstate area by the "roll-in" expedient—*i.e.*, treating the local utility and a distinct out-of-state entity as a single unit for cost and ratemaking purposes. The state is inconsistently attempting both to create an interstate entity for purposes of establishing costs, and denying its interstate character for purposes of asserting its ratemaking authority. But North Carolina's attempt is equivalent to creating an inter-utility bulk power transaction, to obtain Tapoco's power for Nantahala and its North Carolina customers. This the state utility commission is forbidden to do, both by the Federal Power Act and this Court's pre-Act Commerce Clause cases. See pages 9-10, *supra*.

where the FERC has approved a wholesale rate for purchased power as just and reasonable, the state regulatory body still has the authority to determine whether the purchaser was acting in a prudent manner in entering into a contract to purchase the power at that rate, instead of seeking to buy less expensive power elsewhere.

This case involves no *Pike County* situation.[14] The alternative bulk power supply that North Carolina consumers covet—*i.e.*, the low cost entitlement power that Tapoco gets from TVA in exchange for the power generated at Tapoco facilities—is not available to Nantahala It is being sold to Alcoa to meet the needs of Alcoa's Tennessee operations. North Carolina's assertion of a right to this power for its consumers is based on its finding that there was overreaching by Alcoa in the negotiation of the TVA-Nantahala-Tapoco arrangement (J.S. App. 89a), but the Commission has already corrected for that overreaching by taking away some entitlements from Tapoco-Alcoa and awarding them to Nantahala and its customers (page 5, *supra*). NCUC and the court below simply decided that further corrections would be appropriate. At that point, the decisions of the state authorities became inconsistent with FERC's decision; when that happens, state regulation must give way to federal. *Florida Lime & Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 141-142 (1963); *Northern Natural Gas Co.*, 372 U.S. at 92; *Arkansas Electric Cooperative Corp.*, 461 U.S. at 383-384.

[14] Therefore, this Court need not consider whether, in some other factual context, the *Pike County* analysis would be valid.

II. THE STATE ACTION HERE IN ISSUE ALSO VIOLATES THE COMMERCE CLAUSE

1. Preemption issues most commonly arise in a statutory context, where the question is whether a particular federal statute or regulation is intended to preempt state action. See, *e.g.*, *Pacific Gas & Electric Co.* v. *Energy Resources Conservation & Development Commission*, 461 U.S. 190 (1983). This case is somewhat unusual in that it also involves the closely related, but independent, question whether North Carolina's action is repugnant to the Commerce Clause itself.

We submit that the state's action here, designed to further narrow parochial interests, is precisely the sort of regulation the Framers wished to remove from the control of the individual states in reserving to Congress the power "[t]o regulate Commerce * * * among the several States" (Art. I, § 8, Cl. 3).

In altering the allocations of entitlement power established by FERC, NCUC has attempted to establish a system that will be more favorable to the local ratepayers. See *State ex rel. Utilities Commission* v. *Edmisten*, 299 N.C. 432, 434, 263 S.E.2d 583, 586 (1980) (directing NCUC, at an earlier stage in this proceeding, to consider whether reallocation of power "would be in the best interests of the customers of Nantahala"). It is understandable that North Carolina wants lower prices for its residents. But there is only a limited amount of the inexpensive entitlement power available, and it is not enough to satisfy the needs of customers in both North Carolina and Tennessee—Nantahala and Alcoa. In this situation, the Tennessee interests (see note 8, *supra*) are entitled to a decisionmaker with a less parochial perspective than NCUC. Not only the Federal Power

Act, but also the Commerce Clause, gives them that right.

This Court has recognized that in granting power over interstate commerce to Congress, rather than simply leaving all power over commerce to the states, "[t]he Commerce Clause was designed 'to avoid the tendencies toward economic Balkanization that had plagued relations among the colonies and later among the States and under the Articles of Confederation.'" *South-Central Timber Development, Inc.* v. *Wunnicke*, No. 82-1608 (May 22, 1984), slip op. 9, quoting from *Hughes* v. *Oklahoma*, 441 U.S. 322, 325 (1979). More specifically, as this Court explained in an analogous context in *New England Power Co.* v. *New Hampshire*, 455 U.S. at 338-339 (citations omitted): "[o]ur cases consistently have held that the Commerce Clause * * * precludes a state from mandating that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its borders or to the products derived therefrom." That principle invalidated the attempt of the New Hampshire utility commission in that case "to gain an economic advantage for New Hampshire citizens at the expense of [the utility's] customers in neighboring states" by requiring the utility, as a condition of sending power out of the state, to sell an equivalent amount of electricity to New Hampshire customers at rates reflecting the low costs of producing hydro-electric power within the state. By the same reasoning, the Commerce Clause does not permit NCUC to allocate the entitlement power produced in both North Carolina and Tennessee so as to gain a preferential economic benefit for North Carolina citizens. In either case, "[s]uch state-imposed burdens cannot be squared with the Commerce Clause when they serve only to advance 'simple economic protectionism.'" 455 U.S. at 339 (quoting *City of Philadelphia* v. *New Jersey*, 437 U.S. 617, 624 (1978)).[15] Accord, *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 772 F.2d 404, 416-417 (8th Cir. 1985) (recognizing that cost shifting similar to that at issue here is invalid under *New England Power*).[16]

2. If, contrary to our submissions, the Court were to conclude that the NCUC action affirmed by the court below was neither preempted by the Federal Power Act nor invalid as economic protectionism prohibited by the Commerce Clause, the question would remain whether the state action here by its very nature extends into an area forbidden to the states under the Commerce Clause. This is scarcely a new

[15] "Economic protectionism" may be found on the basis of either discriminatory purpose or discriminatory effect. *Bacchus Imports, Ltd.* v. *Dias*, No. 82-1565 (June 29, 1984), slip op. 6; *City of Philadelphia* v. *New Jersey*, 437 U.S. at 626. The NCUC action is invalid under either standard.

[16] The court below incorrectly concluded (J.S. App. 104a) that this Court held in *Arkansas Electric Cooperative Corp.*, that the traditional rate making functions of state public service commissions can never amount to economic protectionism. Instead, the Court simply held that in that case, where the local interests obviously dominated, economic protectionism was not involved. 461 U.S. at 394, 381.

The reliance of the court below (J.S. App. 105a) on this Court's remark in *Arkansas Electric Cooperative Corp.*, 461 U.S. at 395, that "the national fabric does not seem to have been seriously disturbed by leaving regulation of retail utility rates largely to the States" is also misplaced. As we have shown (page 12, *supra*), the working system to which the Court referred includes the requirement that states in setting retail rates will recognize the federal determinations embedded in earlier stages of operations—*i.e.*, the "filed rate" principle.

problem. Indeed, it was precisely in order to resolve the "dilemma" of "[m]aintaining the proper balance between federal and state authority in the regulation of * * * energy utilities" that the Federal Power Act was enacted. *Arkansas Electric Cooperative Corp.*, 461 U.S. at 376-379. That Act was designed to "fill the gap" created by the decision in *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, *supra*, that the states lacked power to regulate electric utility transactions that imposed a direct, rather than an indirect, burden on interstate commerce (*Arkansas Electric Cooperative Corp.*, 461 U.S. at 379). If that "gap" were not entirely closed, so that, despite the Federal Power Act, there remained some area in which the states may enact regulations that impose a substantial burden on interstate commerce,[17] the courts would have to review each instance of such attempted regulation to determine whether it constituted even-handed, nondiscriminatory regulation. See *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); *City of Philadelphia* v. *New Jersey*, 437 U.S. at 624; *Hughes* v. *Oklahoma*, 441 U.S. 322, 331 (1979); *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 36 (1980).

This approach would pose very difficult, if not intractable, problems not only for the courts, but also

[17] Although this Court's pre-*Attleboro* decisions drew a bright line of demarcation between interstate and intrastate commerce where the power entered the local distribution system, more recent cases have found that line more difficult to draw, in light of modern Commerce Clause jurisprudence. See *FERC* v. *Mississippi*, 456 U.S. 742, 757 (1982); *Arkansas Electric Cooperative Corp.*, 461 U.S. at 390-393. The difficulty is only exacerbated by the modern structure of the power industry, with an interconnected national grid involving constant transfers of power across state lines. See page 2, *supra*.

for the utilities involved, since, as we have explained (pages 18-19, *supra*), a utility serving customers in a number of states might find itself subject to a number of state regulatory decisions, each one "reasonable" in itself, but taken together having the net effect of denying the utility a fair return. See *Massachusetts* v. *United States*, 729 F.2d 886, 888 (1st Cir. 1984). There is, for the reasons explained above, no need for this Court to embark on that path in this case. The state utility commission is attempting to obtain for Nantahala's North Carolina customers the economic benefits of cheap power allocated to Tapoco's Tennessee customer under bulk power agreements subject to the undisputed jurisdiction of FERC. That attempt clearly infringes upon the authority reserved to FERC under the Federal Power Act, and seeks to impose an impermissible burden on interstate commerce under this Court's pre-Act Commerce Clause cases.

CONCLUSION

The judgment of the Supreme Court of North Caroline should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOANNE LEVEQUE
Attorney
Federal Energy Regulatory Commission

JANUARY 1986

☆ U. S. GOVERNMENT PRINTING OFFICE: 1986 491507 20138

No. 85-568

In The
Supreme Court of the United States
October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY; TAPOCO, INC.; AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA EX REL. UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL; ET AL.,

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF THE STATE OF TENNESSEE AS AMICUS CURIAE IN SUPPORT OF APPELLANTS

W. J. Michael Cody
Attorney General of Tennessee

Jim G. Creecy
Counsel of Record
Associate Chief Deputy Attorney General

Charles L. Lewis
Deputy Attorney General
450 James Robertson Parkway
Nashville, Tennessee 37219
(615) 741-2968

Counsel for the State of Tennessee, as Amicus Curiae

COCKLE LAW BRIEF PRINTING CO., (800) 835-7427 Ext. 333

QUESTIONS PRESENTED

1. Whether under the Commerce Clause a state, in setting retail electric rates within its borders, may give its citizens a preference to the inexpensive hydroelectric power generated and consumed in a multistate area?

2. Whether one state, in regulating retail electric rates within its borders, may set aside the interstate allocations of wholesale power and costs established by the Federal Energy Regulatory Commission, and impose a different allocation of costs which is more favorable to its own citizens?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

No. 85-568

In The

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY; TAPOCO, INC.; AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA EX REL. UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL; ET AL.,

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF THE STATE OF TENNESSEE AS AMICUS CURIAE IN SUPPORT OF APPELLANTS

In accordance with this Court's Rule 36, the State of Tennessee, through its Attorney General, W. J. Michael Cody, and on behalf of its Department of Economic and Community Development, submits this brief as amicus curiae in support of appellants, Nantahala Power and Light Company; Tapoco, Inc.; and the Aluminum Company of America. Authority for the filing of the brief is found explicitly at Supreme Court Rules 36.2 and 36.4.

INTEREST OF THE STATE OF TENNESSEE AS AMICUS CURIAE

This case concerns the basic design of our federal system of government and the relationship of the states to each other and to federal authority. It involves the rights of the State of Tennessee and of its citizens within that framework. Tennessee has a vital interest in this case, both for jurisdictional reasons and because of its immediate impact on the economy of the State and the livelihoods of its citizens. The decision of the court below, if left undisturbed by this High Court, will result in North Carolina's having the final authority to control the supply of electricity in Tennessee, without Tennessee's having any meaningful role in the decision-making process. As a result of the parochial decision made in North Carolina, Tennessee will suffer serious economic dislocations. If the Aluminum Company of America plant in Blount County, Tennessee is deprived of the inexpensive power that North Carolina has appropriated for itself, then the Tennessee facility may well be so uneconomical, in the power-intensive aluminum industry, that it will be forced to close. This would produce severe economic problems in Blount and surrounding counties in East Tennessee, whose industrial base for most of this century has been fashioned around the Alcoa plant. Closing of the plant would cause the immediate loss of approximately four thousand jobs at the Alcoa facility alone, as well as additional thousands of related jobs in the area.

The decision of the North Carolina Utilities Commission, as upheld by the North Carolina Supreme Court, would divert from Tennessee to North Carolina the economic benefits of inexpensive hydroelectric power previously allotted to Tennessee by the Federal Energy Regulatory Commission (FERC). This diversion has been accomplished under the guise of a local ratemaking proceeding in North Carolina, but that makes its effect no less grievous. The peculiar roll-in device utilized by the North Carolina Commission has the direct practical result of overturning the allocation of this power established by the FERC, which regulates the interstate flow of the power resources and associated costs in the region.[1] The North Carolina Commission has done this without considering the needs of Tennessee or its rights under FERC-approved rate schedules, determining instead that North Carolina customers are entitled to a "first call" preference on the inexpensive power resources of the Southern mountains.

Consequently, Tennessee is intensely interested in the outcome of this litigation, believing that adherence to FERC's objective allocation of power and costs will prevent the economic devastation of mid-East Tennessee. This case ought to establish the important principle that one state cannot ignore and wholly supersede the allocation of power and costs among separate states as determined by the FERC. In view of North Carolina's clever attempt to do so, the outcome of this case will have a profound impact in Tennessee.

---o---

[1] The only exception to FERC regulation relates to the Tennessee Valley Authority (TVA), a major supplier of electric power in the region. As a federal government corporation, TVA, under the terms of its enabling statute, establishes its own rates. *See* 16 U.S.C. § 831k.

SUMMARY OF ARGUMENT

Tennessee submits that the decision below is a brazen attempt by North Carolina interests to acquire the benefits of hydroelectric resources properly belonging to Tennessee, without allowing Tennessee an impartial forum in which to assert its claims. In the form of a state commission retail ratemaking proceeding, North Carolina has effectively usurped the role of the FERC and flouted its authority. The decision below violates the Commerce Clause by giving first preference to narrow state interests over those of other states and the broad national economy. It violates the Federal Power Act by rendering meaningless the FERC's allocations of power and costs in the mountain region. Basic notions of federalism guarantee Tennessee a fair and impartial forum and certainly establish that a North Carolina agency cannot, under any guise, determine the interstate allocation of resources. Thus the decision of the North Carolina Supreme Court must be rejected in its entirety.

ARGUMENT

NORTH CAROLINA, UNDER THE GUISE OF A LOCAL RATE-MAKING PROCEEDING, MAY NOT SET ASIDE ALLOCATIONS OF POWER AND COSTS ESTABLISHED BY FERC AND GIVE ITS CITIZENS PREFERENCE TO THE POWER RESOURCES OF A MULTISTATE AREA.

I.

BACKGROUND

Tennessee shares with North Carolina and other states the power resources of the southern Appalachian region, including a number of hydroelectric generation sites. A portion of the inexpensive hydroelectric power generated in North Carolina and Tennessee historically has been supplied by Tapoco, a Tennessee company, to one of Tennessee's large industrial power consumers, the Aluminum Company of America plant at Alcoa, Tennessee. Tapoco's use of this hydroelectric power to serve the Alcoa facility has been approved by the Federal Energy Regulatory Commission (FERC), the federal agency having exclusive jurisdiction over wholesale electric rates and the allocation of wholesale power among states.

Alcoa has played a major role in the economic development of the mountain region since its entry into the area in the early 1900's. Its participation led to the harnessing of the rivers of the region at an early date, to the benefit of the consuming public as well as itself. Alcoa's Tennessee Operations constitutes one of Tennessee's largest and most valued employers, providing jobs for approximately 4,000 citizens and greatly enhancing the economic

wellbeing of East Tennessee. The lifestyle of several substantial cities, as well as the tax base of the region, is dependent on the economic viability of the Alcoa plant. That plant, in turn, depends on a supply of relatively inexpensive hydropower to blend with more costly TVA power, in order to exist in a competitive environment. Until now, that power supply was assured by allocations of the FERC.

In the instant case, however, the State of North Carolina, through its Utilities Commission, has for all practical purposes overruled the FERC and adopted a new method of distributing power costs in the southern mountain region. It has used as a convenient vehicle the fact that Nantahala Power and Light Company, the utility serving consumers in western Carolina, and Tapoco, Inc., the utility serving the Alcoa plant in Tennessee, are both subsidiaries of Alcoa. While North Carolina's actions take the form of establishing retail rates in that state, the peculiar roll-in device used by the Utilities Commission produces a complete usurpation of FERC regulation. Moreover, when combined with the unjustified presumption that all the inexpensive power should first go to serve the North Carolina public load, the result effectively deprives Tennessee of the protection of FERC's impartial ratemakers.

The result is that Tennessee and one of its most important industrial facilities will be deprived of the benefits of the portion of the inexpensive hydropower allocated to them by FERC. This has been accomplished wholly through ratemaking proceedings in the agencies and tribunals of North Carolina, which are charged under North Carolina law with promoting the interests of North Carolina citizens. Whatever the institutional leanings of the

North Carolina regulatory process, Tennessee has had no opportunity to participate in the decisions at issue. The North Carolina tribunals have acted without regard for FERC's findings, which were derived from proceedings that took into account all the interested parties and to which the North Carolina Attorney General and Nantahala's customers were parties. The FERC determinations were upheld by the United States Court of Appeals for the Fourth Circuit. *Nantahala Power and Light Co. v. FERC*, 727 F. 2d 1342 (4th Cir. 1984). Now the North Carolina authorities have superseded the federal findings and set Nantahala's rates in a manner that directly contradicts them, not only giving Nantahala's customers priority with respect to all the inexpensive hydropower in the region, but imposing a direct financial burden on a customer located in Tennessee. As a result the economy of East Tennessee is threatened with severe dislocations.

The State of Tennessee, as amicus curiae, would emphasize these facts to this High Court and assert that the actions of North Carolina and its Utilities Commission violate both the Commerce Clause, U.S. CONST., Art. I, § 8, and the Federal Power Act, 16 U.S.C. § 791 et seq.

II.

THE NORTH CAROLINA DECISION VIOLATES THE COMMERCE CLAUSE BY INTERFERING WITH THE DISTRIBUTION OF ELECTRICITY BETWEEN STATES.

The decision of the North Carolina tribunals interferes with interstate commerce in order to further the interests of that State at the expense of its neighboring states. It seeks to restrict to North Carolina the benefits

of low-cost power generated in the mountains along the North Carolina-Tennessee border. It denigrates any claim to a part of the hydropower that might be asserted by Tennessee or other states. Electricity, however, is an item in commerce that cannot be hoarded by one state. The Commerce Clause gives all Americans access to our scarce resources and prevents any state from sealing itself off from the national economy.

The decision below does not physically prevent the flow of electric current, but its economic effect is exactly the same. It amounts to a burden on the transfer of power from North Carolina to Tennessee, since it reassigns the benefits of low-cost hydropower from Tapoco's customer in Tennessee to Nantahala's customers in North Carolina. The decision thus directly conflicts with *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1982). In that case New Hampshire did not prevent the flow of power across its border, but it set retail rates as if hydropower exported to other states had been consumed in New Hampshire. This Court struck down New Hampshire's efforts, holding its actions to constitute a burden on commerce. The instant case fits into the same category.

A similar approach has recently been adopted by the Eighth Circuit in *Middle South Energy, Inc. v. Arkansas Public Service Commission*, 772 F. 2d 404 (8th Cir. 1985). In that matter the FERC had allocated power and associated costs among related utilities in four states. Those included the high cost of a nuclear power plant. Arkansas tried to reject those costs in setting retail rates, so its consumers would bear none of the nuclear plant costs. The Eighth Circuit held that Arkansas had contravened the

Commerce Clause since it gave its citizens a preference over those of other states.

The North Carolina decision expressly is designed to further the best interest of the customers of Nantahala, all of whom are North Carolinians. It gives those customers a preference on all the electric energy output of the combined systems of Nantahala and Tapoco. *See North Carolina ex rel. Utilities Commission v. Edmisten*, 299 N.C. 432, 435, 263 S.E.2d 583, 586 (1980); Appendix to Jurisdictional Statement at 183a. It ignores the countervailing interests and needs of Tennessee. It represents precisely the sort of burden on commerce that the Constitution prohibits. *See Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927); *Edgar v. MITE Corp.*, 457 U.S. 624 (1982).

Indeed, the decisions below give the customers in North Carolina preference with respect to all the cheap power, both that generated in North Carolina and that generated in Tennessee. Under their reasoning, as Nantahala's load grows, Tennessee in a few years will receive none of the hydroelectric power. North Carolina has thus instituted a blatantly protectionist policy that significantly impedes the flow of electric power in interstate commerce. By so doing it has infringed the Commerce Clause. Tennessee contends that this Court should act in the interest of the national economy and ensure the rights of Tennessee and other states to an unimpeded power supply.

III.

THE NORTH CAROLINA DECISION INFRINGES THE FEDERAL POWER ACT BY REJECTING COSTS ESTABLISHED BY FERC.

The Federal Power Act contemplates that the FERC will regulate the sale and transmission of electricity among the several states and establish wholesale power costs. The states are then to include these costs in determining retail rates for the domestic utilities which they regulate. Under the "filed rate" doctrine, state commissions must treat the rates fixed by the FERC as reasonable operating expenses for all purposes. *See Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246 (1951). This does not prevent a state commission from finding that increases in FERC-approved rates are offset by savings in other facets of the utility's operations. It does mean, however, that the rates set by FERC are the foundation of any such calculations of retail rates. Nevertneless, the decision below has rejected the FERC's determinations about Nantahala's power costs and has reconsidered all aspects of its operations, reaching conclusions diametrically opposed to those of FERC when it considered the same matters. Such flouting of the rate schedules established by FERC cannot be tolerated under the Federal Power Act.

Under the approach adopted by the North Carolina Supreme Court, the Utilities Commission in that state may wholly disregard FERC's determinations and decide for itself that electricity arrangements between states are unreasonable. It may then refuse to permit local utilities to recover the costs they incur under FERC's wholesale rate schedules. While the decision below does not propose

to overturn the FERC's decision, its result is exactly that. The costs that consequently are not then covered by the North Carolina rates are shifted to consumers in other states.

The absurdity of the North Carolina view is best illustrated by supposing the Tennessee Public Service Commission might take the same approach and decide Tapoco's rates are too high and that Tennessee should have first call on all the inexpensive hydropower.[2] Tennessee clearly has authority to regulate the retail sale of power by Tapoco to Alcoa, just as North Carolina may regulate the retail sale of power by Nantahala to its customers. Tennessee law vests this regulatory authority in the Tennessee Public Service Commission. TENN. CODE ANN. §§ 65-4-104, 65-4-116. Indeed, the instant record shows that the Public Service Commission has previously asserted its right to control such rates. *See* Exhibit T-5, Opinion and Order of Tennessee Public Service Commission re Construction of Chilhowee Dam, Decretal Paragraph 1(a). If the Public Service Commission should choose to ignore the FERC and proceed along the same lines as the North Carolina Utilities Commission by allotting virtually all the power of both utilities to Tennessee an impasse would result. This would leave both Tapoco and Nantahala (as well as their parent Alcoa) in limbo, since neither could recover its cost of service, and both might be unable to serve their customers.

---

2 The history of the development of hydropower in the Southern mountains and the allocation thereof might well be viewed as giving Tapoco a far better claim to the cheap power than Nantahala or any North Carolina interests.

The role of FERC in power regulation at the wholesale level is inconsequential if its determinations do not carry through to influence retail rates. For this reason many courts have held that state commissions must provide for FERC-approved wholesale charges in establishing retail rates. *See Washington Gas Light Co. v. Public Service Commission*, 452 A. 2d 375 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983); *Narragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A. 2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978). This obviously means that the states may not reexamine FERC's wholesale cost allocations, but must accept them at face value and incorporate them in their decision-making. *See Northern States Power Co. v. Minnesota Public Service Commission*, 344 N.W. 2d 374 (Minn.), *cert. denied*, — U.S. —, 104 S.Ct 3546 (1984); *Northern States Power Co. v. Hagen*, 314 N.W.2d 32 (N.D. 1981); *Office of Public Counsellor v. Indiana & Michigan Electric Co.*, 416 N.E.2d 161 (Ind. App. 1981).

These issues were examined in the recent opinion of the New Hampshire Supreme Court in *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985). There the court held that FERC approval of a wholesale rate precludes a state from questioning the reasonableness of that charge. The court observed that the correct approach

> is to examine those matters *actually determined*, whether expressly or impliedly, by the FERC. As to those matters not resolved by the FERC, State regulation is *not preempted provided that* State regulation would not contradict or undermine FERC determinations and federal interests, or impose inconsistent obligations on the utility companies involved. (emphasis in original)

498 A.2d at 704. Thus any state determinations must not call FERC decisions into question and are required to

preserve the integrity of the FERC rate. *See also Pike County Light & Power Co. v. Pennsylvania*, 465 A.2d 735 (Pa. Commw. Ct. 1983).

Here the effect of the decision below is to overturn a FERC decision by contradicting at many points its findings in approving the agreements and schedules affecting Nantahala. The approach used by the North Carolina Commission was to "roll-in" the power supplies and costs of Nantahala and Tapoco as if they were one system, and then to allocate to Nantahala the lion's share of low-cost power, leaving only a minimal amount for Tapoco. Under this approach, and if current trends continue, within approximately eight years Tapoco will be allotted no hydroelectric power. This is directly contrary to FERC's determination that the wholesale rate schedules between the parties are fair to all concerned. This unilateral action of North Carolina has left Tennessee without any voice in the decision-making process and has nullified the authority of the FERC in North Carolina. Such blatant violation of both the letter and the intent of the Federal Power Act cannot be tolerated by this High Court.

IV.

THE DECISION BELOW IS FUNDAMENTALLY AT VARIANCE WITH OUR FEDERAL SYSTEM.

The decision of the North Carolina tribunals is an affront to Tennessee's sovereignty and the comity that ought to exist between neighboring states. The regulation of interstate commerce in instances such as this was a paramount reason for the creation of the Federal Union and the Constitution. This Court ought to review such a blatant

attempt by a state to gather unto itself scarce economic resources at the expense of its sister state, and without allowing that sister state a role in the decision-making process.

This case is of great, immediate importance to the economy of Tennessee. It is of even greater precedential importance to the electric power industry and to regulatory commissions in other states, many of which are being tempted to ignore FERC cost allocations and give their constituents preference in distributing scarce economic resources. Only this Court can protect the Federal Power Act and preserve the unified national market in such resources envisioned by the framers of the Commerce Clause.

The North Carolina Court has held that a state may examine interstate power allocations and set retail rates wholly without regard for the allocation of wholesale costs made by the FERC. It has rendered the FERC determination in the instant case meaningless. Should each state adopt a similar approach and give its own residents preference in electrical entitlements, the entire system of interstate wholesale power transmission would disintegrate into chaos and petty rivalries. The notion that a state utility commission may ignore FERC-approved wholesale costs in setting local retail power rates would gut the Federal Power Act and disrupt interstate commerce in electricity.

North Carolina claims that its Utilities Commission has merely set intrastate retail rates and, in doing so, pierced the corporate veils among Alcoa, Tapoco, and Nantahala because of the parent Alcoa's misdealings. This finding, however, inevitably involves the same issues decided by the FERC in approving the rate schedules involving these utilities. In reconsidering these matters, North

Carolina necessarily substitutes the judgment of its Commission for that of the federal Commission. This it lacks the power to do.

The purpose of the Federal Power Act is to create an impartial federal forum for determination of the sort of interstate controversies and allocations that the North Carolina Commission seeks to scrutinize. As this case abundantly demonstrates, the agencies of one state simply cannot make fair and impartial decisions between citizens of that state and claimants in other jurisdictions. There is an inherent conflict of interest, particularly since the state tribunal is selected by and accountable to the citizens of that state who are parties to such a dispute, and not by the opposing side.

This is further illustrated by the origins of this case as a North Carolina ratemaking proceeding. No party in that proceeding directly represented the interests of Tennessee and its citizens. Indeed, no such concerns of another state would be present in a truly intrastate ratemaking proceeding. The "roll-in" device, however, transformed this case into far more than its origins would indicate. In such state proceedings, the agency members can scarcely be expected to balance fairly the interests of another state.

Upon learning of the peculiar ruling of the North Carolina Commission, Tennessee did attempt to express its concerns to the appellate courts of that state. Tennessee was rebuffed, however, when the Court of Appeals of North Carolina, on December 2, 1982, denied a motion filed by Tennessee for leave to file an amicus curiae brief. While

the Supreme Court of North Carolina later permitted Tennessee to file an amicus brief, it is obvious that Tennessee's interests were hardly taken into account in a context in which Tennessee was uncertain if the courts of North Carolina would even permit its voice to be heard. In its brief to this Court supporting the motion to dismiss or affirm, the Town of Highlands, North Carolina disputed Tennessee's assertion that it had had no opportunity to participate in the decisions below, noting the filing of the amicus brief. (Brief at 2-3 n.3). Such "opportunity", at such a late date, without status as a party, and after rejection of a previous amicus brief, hardly approaches the role Tennessee ought to have from the very inception of a decision that severely impacts its economy and could leave thousands of its citizens unemployed. Tennessee has its proper forum before the FERC; it clearly did not have a forum for its interests in North Carolina.

It is obvious that one state ought not dictate to another the most fundamental decisions affecting that state's economy and resources. The federal Constitution was designed to prevent just such conflicts between states. Congress has effectuated that design by enacting the Federal Power Act, which removes decisions of interstate magnitude from state authority and places them before the FERC, an impartial federal authority.

Tennessee submits that North Carolina must not be permitted to frustrate the Constitution, the intent of Congress, and the role of the FERC by disguising this case as a local ratemaking matter. This High Court ought to vindicate the rights of Tennessee and its citizens and to restrict the North Carolina decision-makers to truly intrastate matters. It can do so by requiring that state's Commission to set Nantahala's rates only after taking fully into account the allocation of power and costs determined by the FERC.

The decision below has spurned the authoritative and impartial decisions of the FERC with regard to Nantahala's wholesale power supply arrangements. It has violated the sovereignty of Tennessee and robbed that state of its fair and historic share of hydropower. It threatens to result in the closing of one of Tennessee's largest and best employers. Thus the North Carolina decision not only violates the sovereignty and comity due Tennessee, but it also portends the economic collapse of a prosperous region and accompanying massive unemployment in Tennessee's tenth largest county. In so doing the North Carolina decision flies in the face of the Constitution, the Federal Power Act, the decision of the FERC, and the case authorities cited in this and appellants' brief. It therefore must be reversed.

o

CONCLUSION

For these reasons, the State of Tennessee submits that the decision of the North Carolina Supreme Court should be reversed and remanded with instructions that the North Carolina authorities set Nantahala's rates with due and full regard for the allocations of power and costs made by the FERC.

Respectfully submitted,

W. J. Michael Cody
Attorney General of Tennessee

Jim G. Creecy
Associate Chief Deputy Attorney General
Counsel of Record

Charles L. Lewis
Deputy Attorney General
450 James Robertson Parkway
Nashville, Tennessee 37219
(615) 741-2968

Counsel for the State of Tennessee, as Amicus Curiae

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,
Appellants,

v.

STATE OF NORTH CAROLINA, ex rel.
UTILITIES COMMISSION; LACY H. THORNBURG,
Attorney General, *et al*,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF
NORTH CAROLINA

MOTION FOR LEAVE
TO FILE BRIEF
AS AMICUS CURIAE
and
BRIEF OF
NEW ENGLAND ELECTRIC SYSTEM
AS AMICUS CURIAE

FREDERIC E. GREENMAN*
THOMAS G. ROBINSON
25 Research Drive
Westborough, Massachusetts 01582
(617) 366-9011
Counsel for New England Electric System

*Counsel of Record

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, ex rel.
UTILITIES COMMISSION; LACY H. THORNBURG,
Attorney General, *et al*.

Appellees.

ON APPEAL
FROM THE SUPREME COURT OF NORTH CAROLINA

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Pursuant to Rule 36.3, New England Electric System (NEES) respectfully moves this Court for permission to file the accompanying Brief as *Amicus Curiae*. The consent of the Appellants has been filed with the Court. The Appellees have withheld consent for the filing. NEES is a registered electric utility holding company under the Public Utility Holding Company Act of 1935, 15 U.S.C. §§79 *et seq*. The electric operations of its subsidiaries parallel the jurisdictional division between the Federal Energy Regulatory Commission and the state commissions. As a result, NEES has a significant and unique

interest in the jurisdictional conflict in this case. That interest may not be adequately presented by the Aluminum Company of America (Alcoa) and its subsidiaries because Alcoa's primary business is not as an electric utility and it is not subject to comprehensive regulation under the Holding Company Act, the Federal Power Act, and state utility law as are NEES and its subsidiaries. As the result of its intimate involvement with jurisdictional questions under the Federal Power Act, including the direct participation of its subsidiary in the decision in *Narragansett Elec. Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978), NEES can contribute to the Court's consideration of the Federal statutory preemption issues raised in this appeal.

For these reasons, NEES requests that it be granted leave to file the accompanying Brief as *Amicus Curiae*.

Respectfully submitted,

FREDERIC E. GREENMAN*
THOMAS G. ROBINSON
25 Research Drive
Westborough, Massachusetts 01582
(617) 366-9011

January 23, 1986

*Counsel of Record

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES (Continued)

TABLE OF AUTHORITIES (Continued)

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, ex rel.
UTILITIES COMMISSION; LACY H. THORNBURG,
Attorney General, *et al,*

Appellees.

ON APPEAL
FROM THE SUPREME COURT OF NORTH CAROLINA

BRIEF OF
NEW ENGLAND ELECTRIC SYSTEM
AS AMICUS CURIAE

STATEMENT OF INTEREST

New England Electric System (NEES) is interested in this case because the Federal Power Act's preemption of state jurisdiction over rates for wholesale electric sales is central to the regulation of NEES' electric utility subsidiaries.

NEES is a registered electric utility holding company system under the Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 *et seq.* Its subsidiaries provide electric service in New England. New England Power Company (NEP) provides the electric generation and transmission for three NEES retail companies that operate in different

states. Granite State Electric Company operates in New Hampshire, Massachusetts Electric Company in Massachusetts, and The Narragansett Electric Company in Rhode Island (together, the Retail Companies).

The activities of NEP and the Retail Companies parallel the jurisdictional division between the Federal Energy Regulatory Commission (FERC) and the state commissions. NEP sells power at wholesale to the Retail Companies under rates that are regulated by FERC under the Federal Power Act, 16 U.S.C. §§ 824 *et seq.*, and the Retail Companies resell the power to retail customers under rates regulated by the state commissions. If the decision by the North Carolina Supreme Court is upheld in this case, NEP and the Retail Companies will face dual regulation of the same costs and inconsistent regulatory obligations.

SUMMARY OF ARGUMENT

The North Carolina decisions in this case[1] are preempted by the Federal Power Act. Under the Federal Power Act, the Federal Energy Regulatory Commission (FERC) has jurisdiction over the sale of electricity at wholesale in interstate commerce. The sale of electricity by Nantahala Power & Light Company (Nantahala) to the Tennessee Valley Authority (TVA) is a sale of electricity at wholesale within the Federal Power Act. FERC has plenary jurisdiction of the rates, terms, and conditions of that sale as well as contracts that in any way relate to the sale. FERC's jurisdiction over the wholesale transaction is exclusive and states are preempted from regulating the transaction directly or indirectly.

State courts that have faced this question have consistently affirmed FERC's exclusive jurisdiction over wholesale sales, and have precluded state commissions in retail rate proceedings from questioning the

[1] The decisions by the North Carolina Supreme Court, the North Carolina Court of Appeals, and the North Carolina Utilities Commission are reproduced in the Appendix to the Jurisdictional Statement ("App.") at pages 1a, 141a, and 165a, respectively.

costs underlying wholesale rates. These state decisions apply squarely to this case. North Carolina has no jurisdiction to base Nantahala's retail rates on a cost allocation that is inconsistent with the FERC-filed New Fontana and 1971 Allocation Agreements. Rather, its exclusive avenue for challenging the Agreements was before FERC in accordance with the remedies in the Federal Power Act.

For these reasons, the decision of the North Carolina Supreme Court should be reversed.

ARGUMENT

I. UNDER THE FEDERAL POWER ACT, FERC HAS EXCLUSIVE JURISDICTION OVER THE NEW FONTANA AND 1971 ALLOCATION AGREEMENTS

At issue in this case is not the fairness of Nantahala's power supply arrangements with the TVA and Nantahala's affiliates. Rather, the issue centers on which commission, state or federal, has the jurisdiction to decide the fairness question. The resolution of the jurisdictional issue is governed by the following principles: (1) under the Federal Power Act, FERC has exclusive jurisdiction over wholesale sales of electricity in interstate commerce; (2) the New Fontana Agreement, under which Nantahala sells power to TVA, and the 1971 Allocation Agreement, which establishes Nantahala's consideration for the sale, are rates for the sale of electricity at wholesale in interstate commerce on file with FERC and subject to FERC's exclusive jurisdiction; (3) state regulatory commissions are preempted from indirectly regulating wholesale rates by reviewing in retail rate proceedings the reasonableness of the costs underlying those wholesale rates and adopting cost allocations at variance with their terms; and (4) North Carolina's exclusive avenue for challenging the wholesale rate was its intervention and complaint before FERC.

These principles have been established in a consistent line of decisions by this Court. They control this case. Because North

Carolina's allocation is inconsistent with the FERC-filed wholesale rate, it is preempted and unlawful.

A. FERC Has Jurisdiction over Wholesale Sales of Electricity in Interstate Commerce

Under § 201(b) of the Federal Power Act, FERC has jurisdiction over "the sale of electric energy at wholesale in interstate commerce. . . ." 16 U.S.C. § 824(b)(1).[2] Over the years, the grant of jurisdiction in § 201(b) has been broadly construed. The scope of the Act's preemptive effect under the Supremacy Clause of the Constitution now extends beyond the strict constitutional limits of the Commerce Clause.

This Court squarely addressed the scope of FERC's jurisdiction in *Federal Power Comm'n* v. *Southern Cal. Edison Co.*, 376 U.S. 205 (1964) (the "*City of Colton*" case).[3] In that decision, the Court

[2] The statute was enacted in response to this Court's 1927 decision in *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927). In the *Attleboro* case, the Court held that the states were barred by the Commerce Clause from regulating these interstate wholesale transactions. In 1935, Congress enacted Part II of the Federal Power Act to close the *Attleboro* gap and bring a uniform system of comprehensive Federal regulation to wholesale power transactions in interstate commerce. S. Rep. No. 621, 74th Cong., 1st Sess. 17 (1935).

[3] The *City of Colton* case arose when the Federal Power Commission (FERC's predecessor) asserted jurisdiction over a wholesale sale of electricity between two California utilities. The Court of Appeals reversed the Commission, relying on the language of § 201(a) of the Act that provides: "such Federal regulation, however, [is] to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a). The Court of Appeals reasoned that the intrastate wholesale transaction was subject to state regulation under the Commerce Clause as it had been construed in *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co.*, *supra*, and that the state retained jurisdiction under the limiting language of § 201(a). This Court rejected the analysis, reversed the Court of Appeals, and affirmed the Commission.

held that the "clear and specific grant of jurisdiction" under § 201(b) of the Act does not depend on a "case-by-case analysis of the impact of state regulation upon the national interest" under the Commerce Clause. 376 U.S. 215.

> Rather, Congress meant to draw a *bright line easily ascertained*, between state and federal jurisdiction, making unnecessary such case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States.

376 U.S. 215-16 (emphasis supplied); *see also Federal Power Comm'n* v. *Florida Power & Light Co.*, 404 U.S. 453, 461, n. 10 (1972).

Thus, the scope of FERC jurisdiction under the Federal Power Act, and therefore of Federal preemption under the Supremacy Clause, does not depend on the constitutional limits on state action imposed by the Commerce Clause. The difference between the analyses under the Supremacy and Commerce Clauses was confirmed in *Arkansas Elec. Coop. Corp.* v. *Arkansas Public Serv. Comm'n*, 461 U.S. 375 (1983). In that case, the Court applied a current Commerce Clause analysis to affirm state regulation of a wholesale sale of electricity by a rural electric cooperative to local distribution cooperatives within the same state.[4] Because cooperatives are exempt from rate regulation under the Federal Power Act, these wholesale sales were not subject to FERC's jurisdiction. As the Court explained, if they were, "we would obviously be faced with a very different pre-emption question." 461 U.S. at 383, n. 7. In that event, "the wholesale rates would . . . be subject exclusively to federal regulation." 461 U.S. at 381.

[4] Specifically, the Court decided that the mechanistic Commerce Clause analysis in *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927) was no longer appropriate. However, the Court reserved judgment on the result that would be produced under the Commerce Clause if the State action directly affected more than one state, as was the case in *Attleboro* and is the case here. *Arkansas Elec. Coop Corp.* v. *Arkansas Public Serv. Comm'n*, *supra*, 461 U.S. at 390, n. 16.

B. The New Fontana and 1971 Allocation Agreements Establish the Rates, Terms, and Conditions for an Interstate Wholesale Sale of Electricity under the Federal Power Act

This case involves a "sale of electric energy at wholesale in interstate commerce." § 201(b), 16 U.S.C. § 824(b). Under the New Fontana Agreement, Nantahala sold all of the electrical output of its hydro facilities to TVA. The 1971 Allocation Agreement established Nantahala's consideration for the sale. The entire transaction was an interstate sale of electric energy to TVA for resale by TVA within the meaning of the Federal Power Act. § 201(d), 16 U.S.C. § 824(d).

Under the Federal Power Act, FERC has jurisdiction over the entire transaction. FERC regulates not only the rates and charges received by Nantahala from TVA, but also all contracts, terms and practices that relate to the sale. Under § 205(c) of the Act, public utilities are required to file with FERC (16 U.S.C. § 824d(c)):

> Schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classification, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

See also 18 C.F.R. § 35.2(b) (definition of "rate schedule" under FERC regulations).

FERC has a statutory responsibility under § 205(a) to assure that "all rates and charges made, demanded, or received by any public utility . . . and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable." 16 U.S.C. § 824d(a). Under § 206(a), the Commission must upon complaint "determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order." 16 U.S.C. § 824e(a). FERC thus has broad jurisdiction over all elements of the interstate wholesale transaction. FERC has exercised its jurisdiction over both the New

Fontana and 1971 Allocation Agreements. Both have been filed with FERC. *See* App. pp. 263a-266a, 286a-287a, 298a-299a.

The "sale of electricity" by Nantahala to TVA distinguishes this case from the cost allocation theory used by the North Carolina Supreme Court to justify its roll-in. App. pp. 32a-72a. Cost allocations are typically required when a single utility provides service in two or more jurisdictions. Each Commission must establish the appropriate portion of the utility's costs devoted to its jurisdictional service. No wholesale sale of electricity occurs under the Federal Power Act, and FERC does not have jurisdiction over the cost allocation. In this case, however, a sale of electricity has occurred. The sale is subject to FERC's exclusive jurisdiction under §§ 201, 205, and 206 of the Federal Power Act. North Carolina may not apply a cost allocation at variance with the FERC-filed rates for the sale. *See Northern States Power Co.* v. *Minnesota Public Utils. Comm'n*, 344 N.W.2d 374 (Minn. 1984), *cert. denied* 104 S. Ct. 3546 (1984).

The distinction between cost allocations and wholesale sales was recognized by this Court in *Colorado Interstate Gas Co.* v. *Federal Power Comm'n*, 324 U.S. 581 (1944).[5] The case involved two companies — Canadian River Gas Company, a producer of natural gas, and Colorado Interstate Gas Company, a pipeline company that transported a major portion of Canadian's gas production from Texas to Colorado. Only a portion of the gas sales was subject to the Commission's jurisdiction under the Natural Gas Act. Thus, the Court was called upon to review both the Commission's cost allocation between jurisdictional and nonjurisdictional sales and the rates for the sale of gas from Canadian to Colorado Interstate.

[5] The *Colorado Interstate Gas Co.* case arose under the Natural Gas Act, 15 U.S.C. § 717 *et seq.* This Court has observed that the pertinent provisions of the Federal Power Act "are in all material respects substantially identical to the equivalent provisions of the Natural Gas Act." *Federal Power Comm'n* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956). Decisions under the two statutes are typically cited interchangeably. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577, n.7 (1981).

The Court first focused on the proper cost allocations between jurisdictional and nonjurisdictional sales under the Natural Gas Act (324 U.S. at 586-95). The Court explained that in the Natural Gas Act (324 U.S. at 589):

> Congress indeed prescribed no formula for determining how the interstate wholesale business, whose rates are regulated [by FERC], should be segregated from the other phases of the business whose rates are not regulated.

Accordingly, the cost allocation was deemed a question of judgment for the Commission "on a myriad of facts." *Id.* The Court concluded that the appropriateness of the allocation "raises questions of fact not of law" (324 U.S. at 590), and affirmed the Commission's allocation.

The Court then turned to the sale of gas by Canadian to Colorado Interstate for resale. 324 U.S. at 595-97. The sale was squarely within the Commission's jurisdiction. The utilities suggested that because the Commission's cost allocations were based on the operation of the two companies as an integrated system, the companies should be treated as a single entity for ratemaking purposes. Under this approach, there would be no wholesale sale between Canadian and Colorado Interstate. The suggestion was rejected by the Court (324 U.S. at 597):

> The difficulty is that Colorado Interstate purchases its gas from Canadian and the purchase price is the interstate wholesale rate which is an operating expense on which Colorado Interstate's resale rates are computed. Moreover, Canadian as required by § 4(c) of the Act has its rate to Colorado Interstate in a rate schedule on file with the Commission. Unless and until a new rate schedule was filed or the old schedule changed by the Commission, that rate would have to be exacted by Canadian and paid by Colorado Interstate. § 4(d).

In this case, Nantahala has made a wholesale sale to TVA. That sale is governed by the New Fontana and 1971 Allocation Agreements. Like the wholesale sale in the *Colorado Interstate* case, the rates fall squarely within FERC's jurisdiction under the Federal Power Act.

The FERC-filed rates must be recognized by North Carolina in retail rate proceedings.

C. FERC's Jurisdiction over the New Fontana and 1971 Allocation Agreements Is Exclusive

FERC's jurisdiction over Nantahala's sale to TVA is exclusive. A state may not intrude either directly or indirectly on any element of the FERC regulated transaction. This Court addressed the issue in *Northern Natural Gas Co.* v. *State Corp. Comm'n*, 372 U.S. 84 (1963). The Kansas Supreme Court had affirmed a state commission order requiring an interstate gas pipeline to modify purchase allocations from in-state gas producers on the ground that the State order did not affect the price of gas. This Court reversed, holding that (372 U.S. at 91-92, citations and footnote omitted):

> The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, or for state regulations which would indirectly achieve the same result. These state orders necessarily deal with matters which directly affect the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act. They therefore invalidly invade the federal agency's exclusive domain.

Thus, it is unimportant that the North Carolina court found that its decision did not change Nantahala's wholesale rates. App. p. 76a. The North Carolina decision was based on a detailed investigation of the New Fontana and 1971 Allocation Agreements that govern a wholesale sale of electricity subject to FERC's exclusive jurisdiction. The North Carolina allocation was flatly inconsistent with the FERC-filed rate. Like the attempted allocations in *Northern Natural Gas* (372 U.S. at 91-92), North Carolina's roll-in decision directly affects the ability of FERC "to regulate comprehensively and effectively the [transmission] and sale of [electricity], and to achieve the uniformity of regulation which was an objective of the [Federal Power Act]."

Nor can the North Carolina decision be justified as an appropriate exercise of its authority under state utility law. *See* App. pp. 77a-

80a, 88a-89a. The Federal Power Act preempts inconsistent state action regardless of the source of authority. State courts are preempted from affecting FERC filed rates by awarding damages under state contract law, *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981), and state legislatures are preempted from affecting wholesale rates under their taxing powers. *Exxon Corp.* v. *Eagerton*, 462 U.S. 176, 184-86 (1983); *Maryland* v. *Louisiana*, 451 U.S. 725, 751-52 (1981). As the Court found in *Arkansas Louisiana Gas Co.* v. *Hall*, *supra*, 453 U.S. at 584:

> When a court is called upon to decide whether state and federal laws are in conflict, the fact that state law has been violated does not affect the analysis. Every pre-emption case involves a conflict between a claim of right under federal law and a claim of right under state law. A finding that federal law provides a shield for the challenged conduct will almost always leave the state law violation unredressed.

In this case, both North Carolina and FERC asserted jurisdiction to investigate the same wholesale transactions. The fact that North Carolina came to a different result under state law cannot control. "Congress here has granted exclusive authority over rate regulation to [FERC]" and "when Congress has established an exclusive form of regulation, 'there can be no divided authority over interstate commerce.'" 453 U.S. at 580.

Finally, the affiliate relationship between Nantahala, Tapoco, and Alcoa does not affect the jurisdictional analysis under the Federal Power Act. The Federal Power Act was passed as a direct response to the growth in public utility holding companies. One of the express purposes of Congress when enacting Part II of the Federal Power Act was to bring wholesale electric sales among affiliates under effective national control. S. Rep. No. 621, 74th Cong., 1st Sess. 17-18 (1935).[6]

[6] The Senate Report found that (S. Rep. No. 621, p. 17):

> In recent years the growth of giant holding companies has been paralleled by the rapid development of the electric industry along lines that transcend state boundaries. To a great extent through the agency of the holding company, local operating units have been tied together into vast interstate systems.
>
> * * *
>
> The new part 2 of the Federal Water Power Act would be the first assertion of Federal jurisdiction over this major interstate public utility.

Part II of the Federal Power Act was enacted together with the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 *et seq.*, as a single coordinated piece of legislation. The Public Utility Act, Pub. L. No. 74-333, 49 Stat. 803 (1935). The Holding Company Act provides in Section 13 for regulation of transactions between affiliates by the Securities and Exchange Commission. 15 U.S.C. § 79m; Conference Report on Public Utility Act of 1935, House Report No. 1903, 74th Cong., 1st Sess. 71-72 (1935). Expressly excluded from the coverage of Section 13, however, are wholesale sales of electric energy between affiliates. Section 2(a)(20), 15 U.S.C. § 79b(a)(20). These wholesale sales were simultaneously subjected to plenary rate regulation by the Federal Power Commission under Part II of the Federal Power Act. Thus, Congress intended FERC to be the exclusive arbiter of the reasonableness of interstate wholesale transactions between affiliates.

The legislative history confirms this conclusion. Congress focused sharply on the absence of arm's length bargaining between affiliates and the states' practical inability to regulate these transactions. *E.g.*, S. Rep. No. 621, 74 Cong., 1st Sess. 36, 56-57 (1935). Previously recognized state authority over interstate affiliate transactions was referred to as "purely theoretical." Hearing on H.R. 5423 before House Comm. on Interstate and Foreign Commerce, 74th Cong., 1st Sess. 761 (1935).[7] When enacting the Federal Power Act, Congress not only closed the *Attleboro* gap, but also addressed other features

[7] Prior to the passage of the Holding Company Act and the Federal Power Act, the Court decided, in *Western Distributing Co.* v. *Public Service Commission*, 285 U.S. 119 (1932), that a state commission could constitutionally review the costs underlying the otherwise unregulated wholesale rates of its affiliate in a retail rate proceeding. In that case, the Court noted the potential for abuse caused by transactions controlled by neither market forces nor regulation. Congress eliminated this potential when it closed the *Attleboro* gap and brought wholesale rates under effective and exclusive federal control. See n.1, *supra*. The fact that Congress did not preserve the state's "purely theoretical" authority over wholesale costs underlying transactions between affiliates is consistent with Congress' overall approach to the Federal Power Act. Congress did not in the Act apportion regulatory authority between the states and the federal government along strict constitutional lines. *See City of Colton*, *supra*, 376 U.S. at 215-16.

of the interstate utility business that were "equally immune from state control either legally or practically." S. Rep. No. 621, *supra*, p. 17. Thus, Congress brought all wholesale sales of electricity, including wholesale sales between affiliates, under effective and exclusive federal regulatory control. The North Carolina Supreme Court decision undermines this carefully crafted federal scheme. Its concerns over reasonable rates and affiliate transactions were addressed directly by Congress in the Federal Power Act, and when the "Federal scheme . . . aims precisely at the same ends as does" the state regulation, the state regulation must fall. *Ray* v. *Atlantic Richfield Co.*, 435 U.S. 151, 165 (1978).

In short, Nantahala's sales of electric energy to TVA are "wholesale sales in interstate commerce" under the Federal Power Act. The New Fontana and 1971 Allocation Agreements by which these sales are implemented are subject to FERC's plenary authority under Sections 205 and 206 of the Act. Since these Agreements were accepted for filing as wholesale rates and allowed to take effect by FERC, they establish the only legal price that can be received by Nantahala for its sales to TVA. *Montana-Dakota Util. Co.* v. *Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251 (1951). North Carolina is preempted from changing them in a retail rate proceeding.

II. State Courts Have Confirmed FERC's Exclusive Jurisdiction over Wholesale Rates

Not only does North Carolina lack direct jurisdiction over the wholesale rates, it cannot assert jurisdiction over the rates indirectly by examining the reasonableness of the New Fontana and 1971 Allocation Agreements in a retail rate proceeding and approving a cost allocation at variance with the FERC filed rate schedules. The "bright line" established by Congress contemplates that FERC has the exclusive responsibility for assuring that interstate rates and contracts are just and reasonable. 16 U.S.C. § 824d; *City of Colton*, *supra*. The Federal Power Act and this Court's decisions make clear that Congress did not set up an elaborate federal regulatory process for consideration of wholesale rates, only to have state commissions consider the very same issues in retail rate proceedings. *Northern*

Natural Gas Co. v. *State Corp. Comm'n*, *supra*. For this reason, state courts have consistently held that state commissions are preempted from investigating the costs underlying wholesale rates in retail rate cases.[8]

A. The *Narragansett* Doctrine Precludes a State Commission in a Retail Rate Proceeding from Investigating the Costs Underlying Wholesale Rates

The leading case is *Narragansett Elec. Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied* 435 U.S. 972 (1978). Narragansett, a retail utility, buys all of its power requirements at wholesale from its affiliate NEP under rates regulated by FERC. NEP had filed with FERC an increase in its wholesale rate to Narragansett. The controversy was triggered when Narragansett filed with the Rhode Island Commission to recover from retail customers the increased purchased power expense under the FERC-filed rate. Acting under its authority to regulate affiliate transactions under state law, the Rhode Island Commission investigated in Narragansett's retail rate proceeding the reasonableness of the costs underlying NEP's wholesale rate filing with FERC. The Commission disallowed from retail rates those costs underlying NEP's wholesale filing that it considered "'strikingly' or 'glaringly' unreasonable." *Narragansett*, *supra*, 381 A.2d at 1361.

The Rhode Island Supreme Court reversed. It began by identifying the "bright line" set forth in the *City of Colton* case and found that under the Federal Power Act:

> The result is a blend of state-federal regulation, each with exclusive authority in its respective field. We conclude, therefore, that

[8] *E.g. Narragansett Elec. Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978); *Northern States Power Co.* v. *Minnesota Pub. Serv. Comm'n*, 344 N.W.2d 374 (Minn. 1984), *cert. denied*, 104 S. Ct. 3546 (1984); *Eastern Edison Co.* v. *Department of Pub. Utils.*, 388 Mass. 292, 446 N.E.2d 684 (1983); *Washington Gas Light Co.* v. *Public Serv. Comm'n*, 452 A.2d 375 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981); *Public Serv. Co. of Colorado* v. *Public Utils. Comm'n*, 644 P.2d 933 (Colo. 1982).

jurisdiction to determine the reasonableness of the wholesale rate charged by NEPCO to Narragansett rests exclusively with FERC.

The Court then turned to the Commission's responsibility to allow recovery of reasonable expenses under state law, including reasonable purchased power expense. Citing *Montana-Dakota Util. Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951), the Court concluded that the FERC-filed rate was reasonable as a matter of law. *See also Arkansas Louisiana Gas Co.* v. *Hall, supra*. Thus, the Rhode Island Court held (381 A.2d at 1363):

> that for the purpose of fixing intrastate rates, the PUC must treat NEPCO's R-10 interstate rate filed with the FPC as a reasonable operating expense. Narragansett has met the burden of proof [under state law] by establishing that the price of the contract with its affiliate is the FPC filed and effective rate.

Accordingly, the Rhode Island Court required the State Commission to accept as reasonable Narragansett's purchased power expense under the FERC-filed rate.

The Court looked to state law only for the procedure to be used when reflecting the wholesale power costs in Narragansett's retail rates. Specifically, the Court found that the Commission could suspend Narragansett's retail filing and "investigate the overall financial structure of Narragansett to determine whether the company has experienced savings in other areas which might offset the increased price for power." 381 A.2d at 1363. The key point is that the wholesale rate must be accepted as a reasonable operating expense regardless of the procedure used to reflect that expense in retail rates.

The rationale of the Rhode Island Court has been applied consistently in other states.[9] Those decisions preclude the state commission from crossing the bright line, and investigating the reasonableness of the costs that underlie the FERC-filed wholesale rate. Although the state court holdings recognize procedural flexibility on the part of local

[9] The only state court exception to the *Narragansett* doctrine originated in a decision by a Pennsylvania intermediate appellate court in *Pike County Light & Power Co.* v. *Pennsylvania Public Util. Comm'n*, 77 Pa. Commw.

268, 465 A.2d 735 (1983). In that case, the Pennsylvania Commission had disallowed a portion of Pike County's purchased power expense, not because the costs underlying the wholesale rate were unreasonable, but on the ground that Pike County could have purchased the power from an alternative supplier more cheaply. The Pennsylvania Commission concluded that Pike County's decision to contract for the purchase under the wholesale rate was imprudent and the Court affirmed. Because the state Commission did not focus on the wholesale utility's costs but only on the retail utility's prudence in incurring those costs, the Court found that the Commission's disallowance was an appropriate exercise of retail ratemaking. *See also Appeal of Sinclair Machine Products, Inc.*, ___ N.H. ___, 498 A.2d 696 (1985).

The *Pike County* rationale does not apply to this case for the simple reason that the dispute in this case centers on Nantahala's rates for a sale of power to TVA. No one has argued that FERC lacks jurisdiction to investigate the prudence of a seller's rates under the Federal Power Act.

But *Pike County* should not be followed for a more fundamental reason. The decision is based on an incorrect reading of FERC's jurisdiction and responsibilities under the Federal Power Act. As explained above, the Federal Power Act gives FERC jurisdiction over the "sale" of electricity at wholesale in interstate commerce. Under the Act, FERC must establish "just and reasonable" rates for that sale. Nothing in the Act says that the rates shall be "just and reasonable" only for the seller. Quite the contrary, this Court has uniformly endorsed FERC's responsibility to purchasers and to the public interest in general. *Federal Power Comm'n* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603, 610-18 (1944); *Federal Power Comm'n* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956). For example, FERC must examine the purchaser's alternatives to the wholesale rates as part of its responsibilities to prevent price squeezes and other anticompetitive effects. *Federal Power Comm'n* v. *Conway Corp.*, 426 U.S. 271 (1976). Finally, the statute and legislative history demonstrate that Congress intended to provide effective and comprehensive regulation of both affiliate sales and purchases at the wholesale level. See text accompanying notes 6 and 7; Hearings on H.R. 5423, *supra*, at 760-61. Thus, FERC is the proper and exclusive forum to litigate the justness and reasonableness of wholesale rates from the perspective of both buyers and sellers.

Contrary to the *Pike County* decision, FERC's jurisdiction attaches to the transaction, not just the selling party in the transaction. As this Court found in *Northern Natural Gas Co.* v. *State Corp. Comm'n*, *supra*, 372 U.S. at 91, FERC has exclusive jurisdiction over "all wholesales . . . in interstate commerce . . . whether occurring before, during, or after transmission" in interstate commerce.

commissions to select the manner in which the wholesale power costs are reflected in retail rates, they are premised on the conclusion that state commissions may not challenge the costs underlying FERC-filed wholesale rates in a retail rate proceeding.

The recognition by these courts of complete federal preemption over both wholesale rates and the costs underlying those wholesale rates is correct. Any other approach would result in chaos. If states had authority to independently review costs underlying wholesale rates, utilities and customers would litigate these costs before FERC, and then turn around and start all over before state agencies. Everyone would take two full bites of the apple. The result would be gaps and potential double recovery. FERC would establish its policy for cost recovery on an issue for wholesale rates subject to its jurisdiction, and state ratemaking authorities would establish their own policies *for the very same costs*. The result would be confusion and truly ineffective regulation.

Of course, Congress did not intend this result, and it did not incorporate it in the Federal Power Act. Rather, as the Court found when reviewing the parallel provisions in the Natural Gas Act in *Panhandle Eastern Pipe Line Co.* v. *Public Serv. Comm'n*, 332 U.S. 507, 520 (1947), Congress:

> created an articulate legislative program based on a clear recognition of the respective responsibilities of the federal and state regulatory agencies. It [did] not contemplate ineffective regulation at either level.

Instead, Congress drew the "bright line easily ascertained, between state and federal jurisdiction" found in the *City of Colton* case.

B. The Narragansett Doctrine Applies Squarely to this Case

The *Narragansett* doctrine applies directly to this case. FERC has exclusive jursidiction over Nantahala's sale of power to TVA and the consideration that it receives for that sale under the 1971 Allocation Agreement. The Agreements have been filed with and allowed to become effective by FERC. They establish the only lawful consideration that Nantahala can receive for its sales to TVA. These Agreements must be accepted as reasonable by the North Carolina Commission when setting retail rates.

The North Carolina Court attempted to distinguish the application of these principles on two grounds. First, it simply misread the *Narragansett* line of cases. App. pp. 81a-84a.[10] As explained, those cases look to state law only for the purpose of determining the procedure by which the FERC-filed rate is to be reflected in retail rates. The North Carolina Court converted this limited discretion into the broad proposition that (App. p. 84a):

> a state commission retains the discretion to do exactly what the Commission has done in the instant case: determine that certain of a utility's costs were effectively incurred for the benefit of its shareholder, not its retail consumers, and therefore should be borne by the shareholder, and not by the utility's retail rate payers.

---

[10] The North Carolina Court's discussion of *Public Serv. Co. of Colo.* v. *Public Utils. Comm'n*, 644 P.2d 933 (1982) and *Washington Gas Light Co.* v. *Public Serv. Comm'n*, 452 A.2d 375, 384-86 (D.C. App. 1982), *cert. denied* 462 U.S. 1107 (1983) illustrates the problem. App. 82a-83a. The Colorado decision parallels the Narragansett decision exactly. Like the Rhode Island court, the Colorado court held that the Commission was required to treat the costs under the wholesale rate as reasonable operating expenses for retail ratemaking purposes (644 P.2d 937-40) and that the Commission had the discretion to determine the procedure used to reflect these costs in retail rates. It therefore affirmed the Commission's decision to consider the expenses in a full rate case rather than an automatic rate adjustment.

The North Carolina reading of the *Washington Gas Light Co.* decision is more egregious. App. pp. 83a-84c. Under the North Carolina Court's interpretation of a footnote, the decision gave the local commission discretion to disallow costs under wholesale rates. See 452 A.2d at 385, n. 15. The holding in *Washington Gas Light Co.* is as follows (452 A.2d at 386) (emphasis supplied):

> We hold that the Commission had no authority to disallow as a reasonable operating expense the wholesale purchase cost of natural gas approved by FERC . . . . Because we hold that the Commission had no jurisdiction to rule on the reasonableness of such surcharges, we need not reach, and the *Commission was unauthorized to consider, the issue of whether the GRI charges benefit the District of Columbia ratepayers.*

The *Narragansett* line of cases stands for precisely the opposite conclusion. Those decisions establish that FERC has exclusive jurisdiction to determine whether a utility's wholesale power costs were incurred for shareholders or customers, and the State has neither jurisdiction nor discretion to decide the issue. Contrary to the North Carolina Court's conclusion, the *Narragansett* line of cases recognizes that the state commission must by law accept the wholesale power costs under a FERC-filed rate as a reasonable operating expense in retail rate proceedings.

The second distinction suggested by the North Carolina Court is based on the actions taken by FERC in a Nantahala wholesale rate proceeding. App. pp. 91a-98a. In that proceeding, FERC found the New Fontana Agreement to be reasonable (App. pp. 293a-95a), but adopted a different cost allocation for Nantahala's wholesale customers than the one specified in the 1971 Allocation Agreement. App. pp. 295a-98a. At the same time, FERC declined to reform the 1971 Allocation Agreement. App. p. 298a. The FERC decisions were affirmed on appeal. *Nantahala Power & Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984).

FERC's decision not to reform the 1971 Allocation Agreement that it found to be unfair should not obscure the fact that FERC retains exclusive jurisdiction over both Agreements. The exclusive remedy for North Carolina remains at FERC. This remedy must be pursued within the framework of the Federal Power Act. FERC's jurisdiction does not turn on its ultimate decision. If error exists, it must be pursued before the regulatory agency with the authority to correct it. *See Massachusetts* v. *United States*, 729 F.2d 886 (1st Cir. 1984). FERC's decisions give no license to North Carolina to cross the bright line, go beyond its jurisdictional limits, and "trespass on the authority of the federal agency." *Maryland* v. *Louisiana*, *supra*, 451 U.S. at 751. The North Carolina decision does just that. It should be reversed.

CONCLUSION

For the reasons stated, the decision of the North Carolina Supreme Court should be reversed.

Respectfully submitted,

Frederic E. Greenman*
Thomas G. Robinson
25 Research Drive
Westborough, Massachusetts 01582
(617) 366-9011
Counsel for Amicus Curiae
New England Electric System

January 23, 1986
*Counsel of Record

(5)

No. 85-568

In The

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, Attorney General, *et al.*,

Appellees.

On Appeal From The Supreme Court Of North Carolina

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF OF EDISON ELECTRIC INSTITUTE AS AMICUS CURIAE IN SUPPORT OF THE APPELLANTS

ROBERT L. BAUM
Counsel of Record
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-7400

Of Counsel:

RICHARD M. MERRIMAN
ROBERT S. WATERS
REID & PRIEST
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036

January 1986

COCKLE LAW BRIEF PRINTING CO., (800) 835-7427 Ext. 333

40, 1

No. 85-568

In The

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., and ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, *Attorney General, et al.,*

Appellees.

On Appeal from the Supreme Court of North Carolina

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Pursuant to Rules 36 and 42 of the Rules of the United States Supreme Court, the Edison Electric Institute (EEI) respectfully moves for leave to file the attached brief as *amicus curiae*.[1] EEI previously filed a motion for leave to file a brief as *amicus curiae* in support of the Jurisdictional Statement in this appeal; by order issued December 9, 1985, that motion was granted.

[1]While the appellants have consented to the filing of the attached brief as *amicus curiae*, the appellees have not. The appellants' letter providing consent has been filed with the Clerk of the Court.

SPECIAL INTEREST OF EDISON ELECTRIC INSTITUTE

EEI is the national association of investor-owned electric utility companies in the United States. EEI's members, in significant contrast to the Aluminum Company of America (Alcoa), obtain substantially all, if not all, their operating revenues and income from sales of electricity to consumers at rates regulated by state commissions (or local regulatory bodies) and the Federal Energy Regulatory Commission (FERC). At the retail level, EEI's members conduct their businesses in accordance with the broad duty of public utilities to serve the public.

Central issues in the decision below involve the relationship, consistent with federal preemption doctrine, between the separate powers of the FERC and the North Carolina Utilities Commission (NCUC) to regulate electric rates, and limitations imposed by the Commerce Clause of the United States Constitution on the power of the state of North Carolina to regulate the economic benefits of hydroelectric power generated within its borders. These issues are vitally important to electric utility companies and their customers, and the final opinion in the case may become a significant and far-reaching precedent.

Alcoa owns two companies which generate electric power within the state of North Carolina for sale in interstate commerce. These companies were parties to the rate proceedings before the NCUC which gave rise to this case. Unlike EEI's member companies, however, Alcoa is not primarily in the business of owning properties to generate electricity for sale to the public pursuant to federal and state rate regulation. Instead, Alcoa obtains practically all its revenues and income from the production and sale

of aluminum products. Since the production of aluminum requires large amounts of electric power, Alcoa is principally a consumer of electricity, not a producer.

Therefore, EEI is in a unique position to approach the issues from the perspective of electric utilities and their customers, which have a vital interest in the outcome. The attached brief as *amicus curiae* demonstrates that the questions arising in the case are substantial and may seriously affect the regulatory domain of electric utilities and their customers.

CONCLUSION

For the reasons set forth above and in the attached brief, EEI urges the Court to grant its motion for leave to file the attached brief as *amicus curiae*.

Respectfully submitted,

Robert L. Baum
Counsel of Record
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-7400

Of Counsel:

Richard M. Merriman
Robert S. Waters
Reid & Priest
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036

QUESTIONS PRESENTED

Whether the preemption doctrine is violated by a rate decision of the North Carolina Utilities Commission allocating power supply costs in a manner different than those same costs were allocated by the Federal Energy Regulatory Commission when the FERC exercised its jurisdiction over federally regulated rate schedules, including the rate schedules under which the costs were incurred.

Whether the state commission's decision violates the Commerce Clause of the United States Constitution since it gives retail electric customers located in North Carolina a preference over an out-of-state customer with respect to the economic benefits of hydroelectric power generated within North Carolina.

PARTIES BELOW

The appellants in the North Carolina Supreme Court were Nantahala Power and Light Company, Tapoco, Inc., and Aluminum Company of America.

The appellees were State of North Carolina, *ex rel.* Utilities Commission; Lacy H. Thornburg, Attorney General; Public Staff of the North Carolina Utilities Commission; Henry J. Truett; Town of Bryson City; Swain County Board of County Commissioners; Cherokee County; Graham County; Jackson County; Town of Andrews; Town of Dillsboro; Town of Robbinsville; Town of Sylva; Tribal Council of the Eastern Bank of Cherokee Indians; Muriel Maney; and Derol Crisp.

TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

OPINION BELOW

The opinion below is reproduced in the Appendix to the Jurisdictional Statement (A. 1a-138a) and reported at 313 N.C. 614 and 332 S.E.2d 397.

JURISDICTION

This Court has jurisdiction under 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The United States Constitution, Article VI, Clause 2: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land. . . ."

The United States Constitution, Article I, Section 8, Clause 3: "The Congress shall have Power . . . [t]o regulate Commerce . . . among the several States. . . ."

The pertinent provisions of the Federal Power Act, 16 U.S.C. §§ 791a-828cc, are reprinted at A. 248a-261a.

INTEREST OF EDISON ELECTRIC INSTITUTE

Edison Electric Institute (EEI) is the national association of investor-owned electric utility companies in the United States. Its members serve approximately 96 per cent of all customers of the investor-owned segment of the electric utility industry and 73 percent of the nation's electricity users.

Today, many EEI members obtain a portion of their total supply of electrical capacity and energy (power)

available to sell to their retail customers through interstate, wholesale purchases from other utilities or from generating companies at rates regulated exclusively by the Federal Energy Regulatory Commission (FERC). For example, a typical EEI member will have wholesale purchase agreements with neighboring utilities. Additionally, many of EEI's members participate in interstate, multi-party power pools which include provisions for reciprocal wholesale sales and exchanges of power.

In these arrangements, ratemaking jurisdiction almost always rests first with the FERC and then with at least one state commission (or local agency) which establishes the retail rates that are necessary to pass through the costs of the wholesale supplies to the ultimate consumers. More than one state commission will be interested in the wholesale arrangement if there are several purchasers with service areas in different states. Therefore, many EEI member companies are exposed to a blend of regulation that includes FERC and at least one state commission and, quite possibly, may include two or more state commissions. This blend of regulation has created serious ratemaking conflicts.

The amount of electric power available for retail consumers that is supplied by arrangements involving wholesale purchases is enormous and will continue to increase. The costs associated with the largest of these wholesale arrangements, which sometimes have expected durations of approximately 30 years, may be measured in billions of dollars, and the planning involved to complete large projects consumes many years.

The legal principles involved in this case thus has great significance to EEI's members since the principles will affect the opportunity for recovery through state-regulated retail rates of costs established by the FERC.

STATEMENT OF THE CASE

EEI adopts the Statement of the Case presented in the Jurisdictional Statement.

SUMMARY OF ARGUMENT

In the opinion below, the North Carolina Supreme Court recognized correctly that the New Fontana Agreement and the 1971 Nantahala Tapoco Apportionment Agreement are rate schedules regulated exclusively by the FERC. Further, the lower court found that the North Carolina Utilities Commission (NCUC) is "preempted from directly or indirectly regulating the wholesale rate structure created" by the rate schedules or "inquiring into the reasonableness of those FERC-filed wholesale rate schedules when it acts in fixing Nantahala's retail rates." A. 75a.

The lower court ruled incorrectly, however, that the preemption doctrine (known as the Naragansett Doctrine when applied to utility rate regulation) only prevents the NCUC from automatically disallowing costs incurred pursuant to the FERC-regulated rate schedules. A. 81a-82a. Then the court found that although the NCUC reallocated cost responsibility between Nantahala Power and Light Company (Nantahala) and Tapoco, Inc. (Tapoco) for a hydroelectric power supply in a manner different than the FERC had done (or as was provided for directly in the rate schedules as they had been accepted for filing with the FERC),[1] the NCUC had not actually disallowed any costs.

[1]In their Motion to Dismiss Appeal, the Appellees attempt to confuse the issue by drawing a distinction between an inter-

(Continued on following page)

The result of this decision is to shift cost responsibility from retail ratepayers served by Nantahala in North Carolina onto a customer served by Tapoco in Tennessee. Regardless of the lower court's refusal to recognize it as such, the reallocation of cost responsibility between Nantahala and Tapoco is the equivalent of a disallowance of costs to Nantahala which affects the sharing of costs between customers located in different states.

Furthermore, the lower court's opinion cannot be reconciled with leading precedent derived from the most analogous cases, the two *Northern States* cases, as well as *Office of Pub. Counsellor v. Indiana and Michigan Electric Co.* discussed in this brief. Contrary to the beneficial effects of those decisions on the stability of interstate, wholesale power arrangements, the court's opinion threatens the ability of electric utilities participating in wholesale power supply projects to recover their costs. If Tapoco's retail rates were regulated by Tennessee and if Tennessee made a decision similar to that made in this case by North Carolina, the utilities would be caught in the middle, as neither would be allowed to recover its costs.

The lower court's decision also violates this Court's decision in *New England Power Co. v. New Hampshire*, 455 U.S. 331 (1983) (*NEPCO*). As the lower court itself recognized:

> *NEPCO* establishes that a state utilities commission may not grant its citizens a preferred right to the benefit of hydroelectric energy generated by a utility in that state to gain an economic advantage over the utility's out-of-state customers, and that the granting of such a preferred benefit, regardless of how it is effectuated, places a direct and substantial burden on interstate commerce in violation of the Commerce Clause.

A. 98a.

The court fails in its attempt to distinguish *NEPCO* on the grounds that in this case, the NCUC did not purport to prohibit the exportation of energy produced within North Carolina. *NEPCO* clearly recognized that the hydroelectric energy at issue in that case would not be contained within one state in a physical sense. *NEPCO* invalidates all "protectionist regulation" whether it takes the form of special rates (*i.e.*, "rates adjusted to reflect the . . . savings attributable to the low-cost hydroelectric generation", *id.* at 336), such as those adopted by the NCUC, or the form of an order overtly blocking the flow of interstate commerce at a state's borders.

(Continued from previous page)

state cost allocation plan which has been found just and reasonable by the FERC and one which has been merely accepted for filing by the FERC. Such a distinction is without significance under the preemption doctrine. *Montana-Dakota Utilities Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251-252 (1951).

ARGUMENT

I. THE DECISION BELOW VIOLATES THE PRE-EMPTION DOCTRINE.

The center of the controversy is the NCUC's choice of a method of cost allocation used to establish rates applicable to general retail service provided by Nantahala in the State of North Carolina and the effect of that choice on rates applicable to service of a customer in another state. Nantahala and Tapoco are wholly-owned subsidiaries of the Aluminum Company of America, and both are public utilities under the Federal Power Act (the Act), 16 U.S.C. § 824-824k (1985). Nantahala and Tapoco are parties to the "New Fontana Agreement" (the NFA) and the "1971 Nantahala-Tapoco Apportionment Agreement" (the 1971 Apportionment Agreement), which together con-

stitute rate schedules subject to the FERC's exclusive rate jurisdiction under Part II of the Act. The FERC-regulated rate schedules provide for Nantahala and Tapoco to deliver certain hydroelectric power to the Tennessee Valley Authority (TVA), and to receive in return certain entitlements to power, that are then apportioned between Nantahala and Tapoco.

Since Nantahala and Tapoco are separate corporations and have separate generating facilities, they have separate costs of owning and operating those facilities. Likewise, the power apportioned to each in return for the exchange with TVA is separately recorded as part of each company's own resources. Thus, as recorded on their separate books of accounts, Nantahala and Tapoco have their own costs of service. Furthermore, Nantahala's cost of service traditionally has been separately allocated in accordance with authorized methods of allocation among the different classes of service provided by the company in wholesale and retail rate cases before the FERC and the NCUC.

This approach was followed in a wholesale rate proceeding before the FERC which ran contemporaneously with the retail rate case before the NCUC that underlies this appeal. At issue in the hearing before the FERC were Nantahala's rate schedules for service to its wholesale customers, the NFA and 1971 Apportionment Agreement, all FERC-regulated rate schedules.[2] Although confronted with arguments advanced by parties representing the interests of Nantahala's wholesale and retail customers to disregard the separate corporate identities of Nantahala and Tapoco and thereby to view all entitlements flowing to Nantahala and Tapoco from TVA under the

[2]The town of Highlands, North Carolina contended in particular that the 1971 Apportionment Agreement should be "set aside." A. 288a.

NFA as if Nantahala and Tapoco were one and the same, the FERC specifically rejected such a "roll-in" method. *Nantahala Power and Light Co.*, Opinion No. 139, A. 291a, *aff'd, Nantahala Power and Light Co. v. FERC*, 727 F.2d 1342 (4th Cir. 1984) (hereinafter Opinion No. 139).

Moreover, the ultimate decision reached in Opinion No. 139 reflected a specific allocation of entitlements under the NFA to Nantahala. (The allocation used by the FERC differed from the allocation of entitlements prescribed by the 1971 Apportionment Agreement although the FERC stated that it was not modifying or reforming that agreement.) It is important to recognize that the FERC's decision in Opinien No. 139 endorsed the use of a different allocation of entitlements to Nantahala than would have been derived under the roll-in method sponsored by the parties representing Nantahala's wholesale and retail customers.

A. The Change In Allocation

Although both the NFA and the 1971 Apportionment Agreements are regulated as rate schedules by the FERC, the lower court did not require the NCUC in Nantahala's retail case to follow either the same allocation of entitlements that the FERC used in the wholesale case or the allocation prescribed by the 1971 Apportionment Agreement as it had been accepted for filing by the FERC in 1980. Instead, the lower court upheld the method employed by the NCUC in which Nantahala and Tapoco were first rolled together and a single, combined cost of service was derived. Then, the NCUC allocated cost responsibility to Nantahala and Tapoco on the basis of relative load responsibility. A. 55a. The NCUC's roll-in method was similar to that which the FERC had rejected despite the arguments of parties representing Nantahala's wholesale and retail customers.

In comparison with either the allocation of entitlements made in Opinion No. 139 or that prescribed in the 1971 Apportionment Agreement, the effect of the roll-in method is to produce a lower cost responsibility for Nantahala's general service customers, all of whom are located in North Carolina, and a higher cost responsibility for Tapoco, which serves only Alcoa's industrial load in the State of Tennessee.[3]

In its opinion, the North Carolina Supreme Court recognized that the NFA and the 1971 Apportionment Agreement fall within the "regulatory jurisdiction of the FERC under Part II of the Federal Power Act" (A. 72a) and that, "the North Carolina Utilities Commission is preempted from directly or indirectly regulating the wholesale rate structure created by the New Fontana and 1971 Apportionment Agreements or inquiring into the reasonableness of those FERC-filed wholesale rate schedules when it acts in fixing Nantahala's retail rates." A. 75a. To avoid the obvious problem with established principles of preemption as applied to utility ratemaking,[4] the lower court

[3]As the lower court recognized, objection to the NCUC's decision to use the so called roll-in method lies not only with the roll-in itself but with the related cost allocation method used to apportion the combined cost between Nantahala and Tapoco. A. 55a. For example, as asserted by the appellants, the worst aspect of the NCUC's cost allocation method is its use of an assumed level of entitlements that exceed actual entitlements under the NFA. Jurisdictional Statement at 10-11. The important and undisputed point for the purpose of this brief is that the NCUC's method did not follow either the FERC-regulated rate schedules or Opinion No. 139 in choosing a cost allocation method; therefore, cost responsibility was reallocated between Nantahala and Tapoco.

[4]As applied to utility ratemaking, preemption is frequently referred to as the "Naragansett Doctrine," after the often cited case of *Naragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

made a distinction between approving any effort on the part of the NCUC to "reform the contracts to alter the actual flow of return power [from TVA] thereunder," which it recognized would be patently unlawful, and merely permitting the NCUC to exercise discretion in "choosing between the competing jurisdictional cost allocation methodologies presented by the parties." A. 56a-57a.[5]

Despite the distinction drawn by the lower court, the roll-in method which it approved does produce a different allocation of entitlements to the TVA power for Nantahala and Tapoco than the allocation made by the FERC in Opinion No. 139 or as prescribed in the 1971 Apportionment Agreement. The NCUC implicitly recognized the actual nature of its decision when it stated, candidly, that there was no need to rewrite the NFA formally because the roll-in method was "an alternative solution available" which could be used to rectify the "inequities" in the entitlements created by the Agreements. A. 202a. The lower court's distinction amounts to a legal fiction conceived solely to attempt to avoid a collision with the preemption doctrine as set forth in its opinion.

B. The Decision's Incompatibility With Applicable Precedent

Furthermore, the North Carolina Supreme Court's analysis of the preemption cases brought to its attention is faulty and misleading in its emphasis. First, before analyzing the three most factually similar cases, the court concluded that there exists a preemption rule of general applicability to utility ratemaking which is consistent with

[5]Similarly, in an overly defensive statement, the North Carolina Supreme Court observed that "nothing contained in the Commission's order *purports* to change or modify a single word of the . . . agreements involved, or the actual flow of power thereunder." A. 76a (emphasis added).

the NCUC's decision. As stated by the court, the preemption rule "requiring state commissions to 'treat' costs based upon FERC-filed rates as reasonably incurred operating expenses, thus preventing the automatic disallowance of these costs, has not been held to preclude state authority to determine whether these costs should be automatically passed through to retail consumers in the form of higher rates." A. 81a-82a.

This statement of a preemption rule strains the meaning of the cases from which it is derived.[6] More importantly, the court failed to recognize that those cases involve factual situations significantly dissimilar to the case below. None of those cases called into question a decision on the part of a state commission to allocate entitlements to interstate power supply and related costs between two utilities in a manner different from a plan of allocation found just and reasonable by the FERC pursuant to its authority under the Act.[7]

Second, after shaping a narrow preemption rule on the basis of cases within a limited factual range, the court incorrectly found that the cases "upon which Nantahala and Alcoa place principal reliance . . . do not lead to a different conclusion." A. 84a-85a. Its attempt to distinguish the two *Northern States* cases, *Northern States Power Co. v. Minnesota Pub. Util. Comm'n*, 344 N.W.2d 374 (Minn.), *cert. denied* 104 S.Ct. 3546 (1984) and *Northern States Power Co. v. Hagen*, 314 N.W.2d 32 (N.D. 1981), is contrivance rather than correct reasoning. In both *Northern States* cases, state commissions failed to pass through in the form of higher retail rates the costs of an abandoned power generation project that had been allocated pursuant to a FERC-regulated rate schedule to utilities subject to their retail rate jurisdictions. The supreme courts reversed the orders of their respective state commissions, as even the lower court itself stated, "on the ground that the reasonableness of a . . . wholesale rate filed and approved by FERC cannot be relitigated in a retail rate proceeding before a state utilities commission." A. 85a.

The lower court implicitly recognized that the *Northern States* cases, involving a cost allocation plan established by the FERC for a power generation project, are directly on point. Plainly in an effort to protect retail ratepayers within North Carolina from higher rates at the expense of an out-of-state ratepayer, however, the court contrived the distinction that such cases prohibit only a direct disallowance of costs allocated according to a FERC-regulated rate schedule, whereas the NCUC "did not disallow any of the system costs incurred by both Nantahala and Tapoco under the NFA and 1971 Apportionment Agreement in determining the aggregate rate base and operating expenses of the rolled-in system." A. 86a. Elaborating, the court stated that, "*all costs* attributable to Nantahala and Tapoco were *recognized and allowed* by the roll-in; the difference between 'book' costs and 'reasonable' costs resulting from the Commission's discretionary determination that only a certain percentage of Nantahala's book costs were incurred in serving the combined system's intrastate retail customers." A. 86a.

[6]The cases, beginning with *Naragansett Electric Co. v. Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978), are discussed by the lower court at A. 81a-84a.

[7]Indeed, two of the cases involve research and development expenditures rather than costs attributable to power generation. *Pub. Serv. Co. of Colorado v. Pub. Util. Comm'n of Colorado*, 644 P.2d 933 (Colo. 1982), and *Washington Gas Light Co. v. Pub. Serv. Comm'n of the District of Columbia*, 452 A.2d 375 (D.C. App. 1982), *cert. denied*, 462 U.S. 1107 (1983).

Irrespective of the lower court's view, it is inescapable from the point of view of Nantahala that some of its "book" costs of power generation allocated to it pursuant to the FERC-regulated rate schedules were disallowed by the NCUC.[8] Thus, as a result of the so-called roll-in method, Nantahala's retail customers, all of whom are located in North Carolina, will not pay for Nantahala's production and purchased power costs in the same proportion they would have if the NCUC had respected the FERC-regulated rate schedules; and Alcoa's plant in Tennessee will incur responsibility for the difference.

If Tennessee's state commission were to regulate Tapoco's retail rates[9] and made a similar "discretionary determination that only a certain percentage of [Tapoco's] book costs were incurred in serving the combined system's intrastate retail customers," the two utilities and their parent would be caught in the middle, as neither utility

[8]Taking the lead from the lower court's opinion, the "Appellees" also contend that this "is *not* a case where the NCUC disallowed FERC-approved wholesale power costs on the grounds that such costs were unreasonable" but is instead a case in which the NCUC " . . . allowed all relevant costs in the single-system 'pot' and allocated the proper portion of such rolled-in costs, using traditionally accepted allocation methods, to the Nantahala retail load." Appellees' Motion to Dismiss Appeal and Motion to Affirm Judgment of the North Carolina Supreme Court (Appellees Brief) at 12-13. Appellees argument repeats the court's own empty reasoning without bolstering it. The NCUC's decision results in a disallowance of costs which Nantahala would have incurred under either the FERC-regulated rate schedules as filed or as they were used by the FERC in Opinion No. 139. Moreover, while the NCUC may have used "traditionally accepted" methods of allocation following the roll-in of Nantahala and Tapoco, it is not traditional or commonplace in utility ratemaking for two separate corporations to be rolled together as if they are one.

[9]In a more typical situation than the specific facts of this case present, Tapoco might have a mix of customers similar to Nantahala's; in such a case, it is likely that Tennessee would assume the responsibility of regulating Tapoco's retail rates.

would be allowed to recover its cost of service. The result of this cost shifting could be disastrous if Tapoco and Nantahala were owned by a parent company which derived substantially all its revenues from their retail rates.

The FERC lacks the power to order state commissions to permit recovery through retail rates of regulated wholesale rates. Therefore, absent protection by the courts through enforcement of a sound preemption rule, the ability of Nantahala and Tapoco to render service to their customers would be impaired. EEI notes with concern the State of Tennessee's belief that the North Carolina Supreme Court's decision permits the NCUC to "wholly disregard FERC's determination and decide for itself that electricity arrangements between states are unreasonable," and that the NCUC may "then refuse to permit local utilities to recover the costs they incur under FERC's wholesale rate schedules." Tennessee Brief at 8. If other states read the lower court's decision the same way, and if the decision is upheld as written, wholesale power supply arrangements throughout the nation could be undermined.

The lower court relied on the fiction that all production costs attributed to a combined Nantahala-Tapoco system "were *recognized and allowed*" to avoid the problem of cost shifting caused by the NCUC's order. That reliance is dependent in large part on the validity of the lower court's determination to "pierce the corporate veil" and treat the two affiliated companies as one. However, with regard to a case involving the pass through of power generation costs between two affiliated utilities pursuant to a FERC-regulated rate schedule, the Supreme Court of New Hampshire recently found that the issue of piercing the corporate veil is "within the FERC's domain of

fixing the wholesale rate between these parties." *Appeal of Sinclair Machine Products, Inc.* (N.H. Pub. Util. Comm'n), 498 A.2d 696, 706 ((1985). That court also found that the "modern trend"[10] in applying the preemption doctrine to state regulation of retail electric rates is to preempt the state from considering matters actually determined, whether expressly or impliedly, by the FERC. *Id.* at 703. As discussed, the FERC, in deciding not to adopt roll-in, expressly rejected the argument that it should pierce the corporate veil between Nantahala and Tapoco.[11]

The lower court's treatment of *Office of Pub. Counsellor v. Indiana and Michigan Electric Co.*, 416 N.E.2d 161 (Ind. App. 1981), also is unconvincing. Here again, the case involves an allocation of power generation costs pursuant to a FERC-regulated rate schedule in the context of a retail rate proceeding before the appropriate state commission. Moreover, the device used by the state

[10]The court's reference to a "modern trend" reflects some decisions in lower courts and various regulatory agencies which may be perceived as creating an exception to the rule requiring a state commission to treat FERC-regulated rates as reasonable expenses. *Id.* at 703. *See, e.g., Pike County Light and Power Co. v. Pennsylvania Pub. Util. Comm'n*, 465 A.2d 735 (Pa. Commw. Ct. 1983). The exception, if valid, would permit a state commission to consider the prudence of a utility's decision to make a purchase under FERC-regulated rates in light of other power supply options available to the utility. The decision below does not expressly or impliedly turn on an exception, if any, of this type because the prudence of Nantahala's power supply arrangements with TVA in light of other possible arrangements, if any, is not questioned.

[11]*Accord United Gas Corp. v. Mississippi Pub. Serv. Comm'n*, 240 Miss. 405, 127 So.2d 404 (1961), wherein the Supreme Court of Mississippi rejected the view of the state's retail ratemaking commission that, because the interstate and intrastate companies were affiliated, the commission could disregard the FPC [predecessor to FERC] rates. ("There is nothing to suggest that the FPC will not closely scrutinize this relationship, for the statutory purpose of protecting the public and consumers from exploitation.")

commission to alter the level of costs allocated pursuant to the FERC-regulated rate schedule was a roll-in of the generation resources of two separate corporate identities. The Indiana Court of Appeals struck down the state commission's roll-in, in the words of the coart below, because it constituted "an impermissible collateral attack on the authority of the FERC." A. 87a.[12] Once more, however, the lower court offered the faulty explanation that the NCUC's roll-in was different because it did not result in a disallowance of Nantahala and Tapoco's combined generation costs. Then, it stated that, "Moreover, it is obvious that the 'roll-in' attempted by the Indiana Commission entailed a far more direct intrusion into FERC's regulatory domain. . . ." A. 88a.

The lower court's statement carries an implied admission that the NCUC has intruded on the FERC's authority. The court's distinction between a "far more direct intrusion" and presumably an intrustion of ordinary dimensions should not be accepted. *Federal Power Comm'n v. Southern California Edison Co.*, 376 U.S. 205, 215-216 (1964). ("Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction making unnecessary . . . case-by-case analysis.") See also, *Northern Natural Gas Co. v. State Corp. Comm'n. of Kansas*, 372 U.S. 84, 91-93 (1963). Regardless of the lower court's subjective view of the degree of severity, federal preemption precludes that intrusion.

Lastly, it must be pointed out that the North Carolina Supreme Court concluded its discussion of preemption with a sweeping statement of instances in which, the court said, a state commission can disallow costs incurred under FERC-regulated rate schedules:

[12]*Accord, Sinclair Machine Products*, 498 A.2d 696 (1985).

> [S]tate commissions have been held to expressly retain, under the "filed rate" doctrine, the authority to decline to automatically reflect operating expenses incurred under FERC-regulated rate schedules or contracts in the structure of intrastate retail rates where, for example, the state commission determines (1) that increases in FERC-approved charges in one area of the utility's operations were not [sic] offset by economies in other areas . . . ; (2) that certain FERC-regulated costs were not, either in whole or in part, primarily incurred for the benefit of retail rate payers, but rather for the benefit of the utility's investors . . . ; (3) that in light of available alternatives, certain FERC-approved expenses charged by a parent to the local utility were not reasonably attributable to the costs of serving local rate payers . . . ; and (4) that certain FERC-regulated payments between parent and subsidiary were not required for service to the local rate payers . . . (*citations omitted*)

A. 88a.

While these conclusions, by and large, are based on an incorrect reading of the minority-view cases cited by the lower court, they cannot go unchallenged because this broad language is an invitation to advocates of increased state commission discretion to disallow costs incurred under FERC-regulated rate schedules. Unless this Court erases this statement, it will come back again and again to hobble the FERC in the performance of its statutory duties.

In summary, in finding that the NCUC's order did not violate the preemption doctrine, the decision of the North Carolina Supreme Court is inconsistent with key decisions of the supreme courts of the States of Minnesota and North Dakota and of the State of Indiana's court of appeals in cases far more similar to the case below than any other preemption cases decided by courts to date. If allowed to stand, the decision could imperil the electric utility industry's reliance on FERC-regulated power supply contracts to meet large portions of the nation's demand for electrical power.

II. THE MOTIONS TO DISMISS THE APPEAL DO NOT CONTAIN ANY ARGUMENTS ON THE PREEMPTION ISSUE THAT ARE MERITORIOUS.

Various arguments not previously addressed in this brief were presented in Appellees Brief and in the "Brief for The Town of Highlands, North Carolina, as *Amicus Curiae* Supporting Motion to Dismiss or Affirm" (Highlands Brief), concerning the substance of the decision below. EEI contends that these arguments are devoid of merit.

A. The Faulty Argument That The NCUC's Decision It Not Prohibited By The Preemption Doctrine Since Opinion No. 139 Did Not Allocate Costs Under The NFA And The 1971 Apportionment Agreement

The most pervasive argument found in Appellees Brief and Highlands Brief is that, in effect, the lower court's opinion is compatible with the preemption doctrine since Opinion No. 139 merely determined just and reasonable wholesale rates for Nantahala's wholesale customers without establishing a just and reasonable allocation of entitlements and related costs to Nantahala and Tapoco under the NFA and the 1971 Apportionment Agreement. For example, Appellees contend that: (1) since the ultimate issue resolved in Opinion No. 139 was the justness and reasonableness of Nantahala's wholesale rate increase, "FERC did not review the two Agreements for their *independent* 'justness and reasonableness' " (emphasis added); (2) "FERC viewed the fairness of the Agreements only under § 205 of the Act, for the *limited* purpose of deter-

mining the reasonableness of Nantahala's proposed wholesale rates" (*Id.* at 18) (emphasis added); (3) "FERC did not allocate power and costs with respect to the NFA and the 1971 Apportionment Agreement"; and (4) "the NCUC did not interfere with a FERC § 206 allocation of costs among states or among utilities." Appellees Brief at 18, 20, 22.[13]

Similarly, Highlands contends that: (1) "FERC Opinion No. 139 did not allocate costs between affiliated utilities or between states"; (2) "FERC did not approve or modify the NFA or the 1971 Apportionment Agreement to determine a just and reasonable allocation of costs between North Carolina and Tennessee or between Tapoco and Nantahala"; and (3) "FERC emphasized that in Opinion No. 139 it acted only in the context of establishing just and reasonable rates for wholesale customers and was not purporting to allocate interstate power flows or costs." Highlands Brief at 3, 5, 6.

Although the FERC did not reform either the NFA or the 1971 Apportionment Agreement in Opinion No. 139, it is unreasonable to assume that the FERC did not decide Opinion No. 139 on the basis of a just and reasonable

[13]Commingled with these assertions is a bewildering attempt to describe Opinion No. 139 as an exercise of the FERC's jurisdiction under Section 205 of the Act but not of its jurisdiction under Section 206. Appellees Brief at 14, 15, 16, fn. 19, and 18. *See also* Highlands Brief at 7. While there is a valid distinction between Section 205 and Section 206 for some purposes, such as resolving burden of proof issues or determining whether the FERC may order refunds, the distinction is irrelevant in this appeal. As noted in the quotation from Opinion No. 139-A cited in Highlands Brief at 7, the FERC specifically stated that Nantahala's "proposed rate increase was set for hearing under both Sections 205 and 206 of the Federal Power Act." In fact, the FERC has stated repeatedly that, "Every proceeding under Section 205 of the Federal Power Act involves Section 206 as well." *Pacific Gas and Electric Co.*, 10 F.E.R.C. ¶ 61,304 (1980) at 61,609. *See, e.g., Central Maine Power Co.*, 8 F.E.R.C. ¶ 61,322 (1979) at 61,929.

allocation of entitlements of TVA power and related costs to Nantahala. To the contrary, it would seem impossible for the FERC rationally to have reached a just and reasonable rate level for Nantahala's wholesale business without first having determined a just and reasonable allocation of entitlements and costs of a major source of wholesale power which Nantahala shared with Tapoco as a result of a joint exchange of power with TVA made pursuant to FERC-regulated rate schedules. A wholesale rate could not be deemed just and reasonable by the FERC unless the FERC had arrived at a reasonable determination of the power supply costs to be recovered by the rate.[14]

Not surprisingly therefore, the FERC stated in Opinion No. 139-A that it was concerned that "each party [Nantahala and Tapoco] receive its proper entitlement." A. 309a.[15] Moreover, the FERC's explanation of why it "did not choose to reform the 1971 Apportionment Agreement" is inconsistent with the theory that the FERC did not make an implicit determination on the justness and reasonableness of the NFA and the 1971 Apportionment Agreement. Although it wanted to ensure that Nantahala

[14]As the lower court observed,

> The unique problem posed by this case lies in the fact that Nantahala's available power supply was contractually reshaped by the quantity and design of the entitlements retained by TVA under the NFA and allocated to Nantahala under the 1971 Apportionment Agreement.

A. 55a.

[15]In the "Brief for the United States and the Federal Energy Regulatory Commission as Amici Curiae," the FERC states that Opinion No. 139 involved "determinations . . . concerning how 'entitlements' to certain power, received in return for other power, should be divided between two utilities, serving neighboring states." Brief at 6. This position is neither "inexplicable" as the Appellees contend (Brief at 16, fn. 19), nor "erroneous" as Highlands contends (Brief at 6).

would receive a "proper entitlement," the FERC simply was "not concerned with the mechanics of how entitlements of energy from TVA are allocated to each party." A. 309a. In other words, the FERC did not think it was necessary to reform the 1971 Apportionment Agreement in order to establish a just and reasonable level of entitlements.

Thus, despite the FERC's statement that it did not reform the 1971 Apportionment Agreement, EEI believes that Opinion No. 139 includes a determination by the FERC of a just and reasonable allocation of power supply entitlements and related costs pursuant to FERC-regulated rate schedules. Therefore, EEI sees a conflict between Opinion No. 139 and the NCUC's decision underlying this appeal, and that conflict represents a threat to the preemption doctrine if the opinion below is allowed to stand.

Further, under a corollary or overlapping rule known as the "filed rate" doctrine, if the FERC has accepted certain rate schedules for filing pursuant to the Act but does not alter or modify them, then the provisions of those rate schedules, as accepted for filing, govern any wholesale transaction taking place pursuant to them, and no state commission may order a change in the provisions. *Montana-Dakota Utilities Co. v. Northwestern Public Service Co.*, 341 U.S. 246, 251-52 (1951). Accordingly, a rate schedule accepted for filing with the FERC, although neither approved nor modified, should be given the same weight by a state commission in a retail rate case as a rate schedule that has been modified or reformed by the FERC following an evidentiary hearing. In the context of this case then, resolution of the preemption issue should be the same irrespective of whether the NFA and the 1971 Apportionment Agreement were found to be just and

reasonable with certain modifications or left untouched by the FERC in Opinion No. 139.[16]

B. The Faulty Argument That The NCUC's Decision Is A Proper Exercise Of Its Authority To Adopt Its Own Ratemaking Policies

Appellees and Highlands contend that the NCUC's decision represents the permissible exercise of the NCUC's jurisdiction to regulate retail rates under standards differing from the standards used by the FERC to regulate wholesale rates. See Appellees Brief at 15-16 ("It has been repeatedly recognized that Federal and State regulatory commissions can adopt different ratemaking policies.") and Highlands Brief at 8-10 ("There is no question that states in setting rates to retail customers and the FERC in setting rates to wholesale customers may use different ratemaking methodologies."). This argument is superficial and misplaced.

A typical investor-owned electric utility, such as Nantahala, has wholesale and retail customers. Under our dual regulatory system, the FERC is charged with the duty of ensuring that Nantahala's wholesale rates are reasonable, and the NCUC is charged with the duty of ensuring that Nantahala's retail rates are reasonable. It is recognized that to serve this goal, each commission has authority to establish its own ratemaking standards. For example, the FERC may decide that Nantahala's wholesale rates should be set to give it an opportunity to earn a rate of return allowance of 14 percent, while the NCUC may

[16]Indeed, as observed previously, the North Carolina Supreme Court itself stated emphatically that the NCUC is preempted from " . . . inquiring into the reasonableness of those *FERC-filed* wholesale rate schedules when it acts in fixing Nantahala's retail rates." A. 75a (emphasis added).

find that Nantahala's retail rates should reflect a rate of return allowance of 16 percent.

Everything else equal, this probably would mean that Nantahala's retail rates would be higher than its wholesale rates—a result compatible with dual regulation and not violative of the preemption doctrine. Nantahala is not harmed by the difference; and the stability of the interstate wholesale transactions underlying the FERC's jurisdiction is not threatened.

The NCUC's decision, insofar as it involves a simultaneous allocation of wholesale power supply and related costs of such power among different companies pursuant to FERC-regulated rate schedules (irrespective of whether the FERC has merely accepted them as filed or modified or approved them), presents a different challenge to maintaining order in a dual regulatory system. The longstanding system of utility regulation will fail if the NCUC can disregard an allocation plan used by the FERC. See discussion earlier at 2, 12-13 and Tennessee Brief at 8.

As part of their argument that the NCUC's decision represents a proper exercise of a state commission's authority to adopt its own ratemaking policies, Appellees (Brief at 15) and Highlands (Brief at 9) rely on dictum in Opinion No. 139-A indicating a lack of concern on the FERC's part despite its knowledge that the NCUC had reached "a different conclusion concerning roll-in costing." A. 305a. Similarly, Highlands also argues that there is no basis "for concluding that the FERC intended to require the NCUC to use for retail ratemaking purposes the same assumed entitlements that it used for wholesale rates." Brief at 8. These arguments are unpersuasive.

Opinion No. 139-A is an order on rehearing in which the FERC's immediate concern was explaining why it

had not adopted a roll-in method despite strenuous argu-
ments that it should have.[17] Furthermore, the FERC typi-
cally does not use rate orders to instruct state commissions
on the preemption doctrine. Therefore, it is unreasonable
to assume that Opinion No. 139-A supports the NCUC's
decision simply because the FERC did not express an ob-
jection to it in Opinion No. 139-A. Moreover, application of
the preemption doctrine is not contingent upon an expres-
sion of intent by the FERC "to require" a state commis-
sion to follow the FERC's order. The FERC has no au-
thority to require a state to comply with preemption, nor
does it typically get involved with preemption issues of the
type presented by this appeal as a regular part of issuing
its ratemaking decisions.

Left standing as is, the opinion below threatens the
ability of utilities purchasing bulk power supplies under
rates set by the FERC to obtain or maintain adequate and
stable retail rates. This situation will be particularly
acute when ratemaking jurisdiction is not only divided
between the FERC and a single state commission but in-
stead, among the FERC and more than one state commis-
sion. See Tennessee Brief generally. Furthermore, the de-
cision could jeopardize attempts to plan and finance inter-
state power projects and power pooling agreements that
will be needed in the future to meet expected load growth.
Accordingly, the lower court's decision should not be af-
firmed on the erroneous ground that it involves nothing
more than affirming the authority of a state commission to
adopt its own ratemaking rules and policies.

---

[17]The NCUC's decision had been lodged with the FERC as part of an argument to induce the FERC to change its decision on roll-in, not as part of a brief on the preemption doctrine.

III THE DECISION BELOW VIOLATES THE PROHIBITION AGAINST UNDUE INTERFERENCE WITH INTERSTATE COMMERCE.

Unlike precedent on the preemption issue, which so far has been crafted by lower federal and state courts, precedent on the relationship of the Commerce Clause, U.S. Const., art. I, § 8, cl. 3 (Commerce Clause), to the power of states to regulate the economic benefits of hydroelectric power flowing in interstate commerce is "well-settled." *Middle South Energy, Inc. v. Arkansas Pub. Serv. Comm'n*, 772 F.2d 404 (8th Cir. 1985), *petition for cert. filed*, 54 U.S.L.W. 3393, November 21, 1985 (No. 85-895), A. 330a, because this Court has spoken. *New England Power Co. v. New Hampshire*, 455 U.S. 331, 334 n.10 (1983) (deferring resolution of preemption issue in favor of resolving Commerce Clause issue). Therefore, unlike its analysis of the preemption issue, in which the lower court confused the most significant precedent with precedent derived from similar but less meaningful circumstances, the lower court's analysis of the NCUC's decision in light of the Commerce Clause implicitly recognizes that one case, *New England Power Co. (NEPCO)*, controls.

> We agree with the companies' contention that *NEPCO* establishes that a state utilities commission may not grant its citizens a preferred right to the benefit of hydroelectric energy generated by a utility in that state solely to gain an economic advantage over the the utility's out-of-state customers, and that the granting of such a preferred benefit, regardless of how it is effectuated, places a direct and substantial burden on interstate commerce in violation of the Commerce Clause.

A. 98a.

In not agreeing with the assertion "that the rule announced in *NEPCO* invalidates the action of the Commission in this case" (A. 98a), however, the lower court resorted to the same, superficial form of distinction it drew with respect to the *Northern States* cases and *Office of Public Counsellor v. Indiana and Michigan Electric Co.* The court noted:

> However, unlike the action of the New Hampshire commission, the roll-in performed by the Commission in this case does not *purport* to prohibit the exportation of energy produced within North Carolina, nor does it divert the flow of Tapoco's power to Nantahala. More importantly, the roll-in methodology used by the Commission does not exclusively reserve to the citizens of North Carolina the entire economic benefit of the unified system's low-cost in-state hydroelectric generation.

A. 100a-101a (emphasis added).

The court's reliance on its interpretation of the New Hampshire commission's order as purporting to prohibit the exportation of hydroelectric power produced within New Hampshire is insufficient. In *NEPCO*, this Court decided the Commerce Clause issue knowing that, "[t]he Commission did not, however, order New England Power to sever its connections with the Power Pool." *NEPCO* at 336. Moreover, *NEPCO* is clearly premised on recognition that:

> So long as the electricity produced at New England Power's hydroelectric plants continues to flow through the Pool's regional transmission network, it will be impossible to contain that electricity within the State of New Hampshire in any physical sense. Although the precise contours of the Commission's order are unclear, it appears to require that New England Power sell electricity to New Hampshire utilities in an amount equal to the output of its in-state hydroelectric facil-

> ities, at special rates adjusted to reflect the entire savings attributable to the low-cost hydroelectric generation.

Id. at 336 (footnote omitted).

Thus, although the order of the New Hampshire Commission was cast in terms of prohibiting the export of hydroelectric power outside the state, *NEPCO* invalidates "protectionist regulation" (*Id.* at 339) taking the form of special rates as well as an order overtly blocking the flow of interstate commerce at a state's borders.

Indeed, finding *NEPCO* dispositive, the United States Court of Appeals for the Eighth Circuit recently affirmed the judgment of the district court enjoining the Arkansas Public Service Commission (APSC) from even continuing a show cause proceeding, aimed at protecting the citizens of Arkansas from a wholesale rate increase,[18] although the state's attorney general argued that there was no significant burden on interstate commerce because "the APSC has only issued a show cause order, and not actually voided the contracts in issue." *Middle South Energy*, A. 332a. Furthermore, while the APSC sought to cancel the agreements at issue "because they have not received the necessary state regulatory approval", the court saw that the APSC's motivation was economic protection of its citizens at the expense of citizens in other states. *Middle South Energy*, A. 341a ("Given free rein, the APSC would shift this burden [wholesale rate increase pursuant to the Act] to the citizens of Mississippi and Louisiana, citizens who are powerless to directly influence Arkansas' internal affairs.") In this case, it is also "abundantly plain" (A. 340a) that the NCUC's motivation is to protect Nanta-

[18]The wholesale rate increase reflected the FERC's allocation among several states of the costs of a new generating unit.

hala's general service customers by shifting the burden of a rate increase to another state.

The argument that *NEPCO* is not violated because the NCUC's order does not "exclusively reserve to the citizens of North Carolina the entire economic benefit of the unified system's low-cost in-state hydroelectric generation" is inadequate.[19] Obviously, a great deal of the economic benefit of North Carolina's in-state hydorelectric generation is reallocated to Nantahala. Moreover, the NCUC order gives North Carolina customers the potential benefit of an ever-increasing preference to the less expensive hydroelectric power generated in North Carolina (and Tennessee). See Jurisdictional Statement at 9-12.

The NCUC stated that the cost allocation method chosen by it assumed that Nantahala's public load had a "first call on the total electric energy output of the combined Nantahala-Tapoco system." A. 102a. The court contends, however, that a complete reading of the NCUC's order shows that the NCUC's "initial characterization" of its method as creating a "first call" was in error. A. 103a. Accepting the court's interpretation of the NCUC's order for the sake of argument, the fact remains that, for the reason explained in the Jurisdictional Statement,[20] the order has the effect of giving Nantahala's customers a first call on the cheaper hydroelectric power. In turn, this requires Tapoco to take more expensive power to serve Alcoa's plant in Tennessee.

[19]Appellees repeat the lower court's faulty reasoning but do not point out any merit in it. Appellees Brief at 26-27.

[20]As explained therein, the operative factor is the use of assumed entitlements that exceed actual entitlements under the NFA.

The order is, therefore, an act of simple economic protectionism that is *per se* unlawful under *NEPCO*. The lower court's attempt to characterize the NCUC's order as "even-handed" regulation of the type upheld in *Arkansas Electric Cooperative Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983), also is inadequate. There the choice confronting this Court was between regulation of the cooperative's wholesale rates by the APSC or no regulation in view of the Federal Power Commission's (now the FERC) earlier determination that it lacked jurisdiction over such rates under the Act. The Court's affirmance of the APSC's assertion of jurisdiction by the APSC over otherwise unregulated rates, notwithstanding that the cooperative was tied into the interstate grid, on the basis of a balancing test is plainly different. There was not a hint of discriminatory, economic protection at work in that case.

Furthermore, the bare facts that "the setting of retail electric rates for Nantahala's customers is clearly a legitimate North Carolina interest with a significant impact in this state" and that the price charged to Nantahala's retail customers may only have a "*de minimis*" effect on the "interstate 'grid' " (A. 105a), do not entitle North Carolina to the more lenient balancing test applied in *Arkansas Electric Cooperative* for facially neutral economic regulation. In *NEPCO*, this Court could have applied a similar rationale to uphold the New Hampshire commission's order since New Hampshire clearly has an interest in keeping electric rates within its borders as low as lawfully possible. Thus, the lower court's effort to distinguish *NEPCO* fails.

———o———

CONCLUSION

The Court should overrule the opinion below.

Respectfully submitted,

ROBERT L. BAUM
Counsel of Record
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-7400

Of Counsel:

RICHARD M. MERRIMAN
ROBERT S. WATERS
REID & PRIEST
Suite 1100
1111 19th Street, N.W.
Washington, D.C. 20036
(202) 828-0100

Attorneys for Edison Electric Institute

16

No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., AND ALUMINUM COMPANY
OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA EX REL. UTILITIES COMMISSION,
LACY H. THORNBURG, ATTORNEY GENERAL, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF THE NORTH CAROLINA UTILITIES COMMISSION AS AMICUS CURIAE IN SUPPORT OF APPELLEES

WILSON B. PARTIN, JR.
Deputy General Counsel
(Counsel of Record)
NORTH CAROLINA UTILITIES COMMISSION
430 North Salisbury Street
P. O. Box 29510
Raleigh, North Carolina 27626-0510
(919) 733-3969

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

30PP

TABLE OF CONTENTS

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-568

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., AND ALUMINUM COMPANY
OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA EX REL. UTILITIES COMMISSION;
LACY H. THORNBURG, ATTORNEY GENERAL, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF OF THE NORTH CAROLINA UTILITIES COMMISSION AS AMICUS CURIAE IN SUPPORT OF APPELLEES

In accordance with this Court's Rule 36, the North Carolina Utilities Commission, an agency of the State of North Carolina, submits this brief as amicus curiae in support of the appellees. All of the parties to this appeal have given written consent to the filing of this amicus curiae brief, and the letters consenting to the brief have been filed with the Office of the Clerk of the Court.

INTEREST OF THE NORTH CAROLINA UTILITIES COMMISSION AS AMICUS CURIAE

The North Carolina Utilities Commission ("NCUC") is interested in this case because it is the decision of the NCUC which is on appeal to this Court from the North Carolina Supreme Court. Appellant Nantahala Power and Light Company is a North Carolina public utility, and its retail rates and service are regulated by the NCUC. Aluminum Company of America ("Alcoa") and Tapoco Inc., have also been determined to be public utilities by the NCUC.

The NCUC is vested with authority under the Public Utilities Act of North Carolina to fix retail rates for all public utilities within the State of North Carolina, including electric utilities. N.C.G.S. Chapter 62. Pursuant to the Public Utilities Act, the NCUC is required to fix just and reasonable rates for public utilities and their customers in North Carolina. The rates approved for the retail ratepayers of Nantahala Power and Light Company in this case effectuate legitimate State interests, in that the NCUC has sought to rectify corporate abuse by the Aluminum Company of America, which is the parent of Nantahala.

STATEMENT OF THE CASE

This case now before the Court began on November 3, 1976, when Nantahala Power and Light Company ("Nantahala") filed an application with the North Carolina Utilities Commission ("NCUC") for an increase of $1,830,791 in its rates and charges for its retail customers in southwestern North Carolina. On June 14, 1977, the NCUC issued an Order granting

Nantahala a rate increase of $1,598,918. This decision was ultimately reversed on appeal by the North Carolina Supreme Court in *State ex rel. Utilities Commission* v. *Edmisten*, 299 N.C. 432, 263 S.E. 2d 583 (1980). The basis for the reversal was the failure of the NCUC to give even minimal consideration to evidence concerning the propriety of treating Nantahala and its affiliate Tapoco, both wholly owned subsidiaries of Alcoa, as a single, unified electric utility and rolling together their properties and costs for retail ratemaking purposes. The North Carolina Supreme Court remanded the case to the NCUC with directions ". . . . to obtain and consider information and data showing what Nantahala's cost of service to its customers would be if the roll-in method of rate making were used and whether Nantahala's customers would benefit thereby." (App. p. 13a)

In the remanded proceeding the NCUC found that Alcoa, Nantahala's parent corporation, and Tapoco, Nantahala's affiliate, were public utilities and joined Alcoa and Tapoco as parties. A panel of three Commissioners held extensive hearings on the issues delineated by the North Carolina Supreme Court. On September 2, 1981, the NCUC Panel issued its Order implementing roll-in upon findings that: (1) Alcoa and Tapoco are North Carolina public utilities; (2) the Nantahala and Tapoco electric facilities constituted a single integrated electric system; (3) the Nantahala and Tapoco systems should be treated as one entity for North Carolina retail ratemaking purposes; (4) Alcoa has dominated Nantahala such that substantial benefits to Alcoa and significant detriment to Nantahala's retail customers have resulted from the New

Fontana Agreement ("NFA") and from the 1971 Apportionment Agreement.

Based upon these findings, the NCUC combined the rate base and expenses of the unified Nantahala-Tapoco electric system, allocated the appropriate costs to Nantahala's North Carolina retail jurisdiction, and set retail rates for Nantahala. The combined Nantahala-Tapoco system costs being lower than the costs of Nantahala as a "stand alone" company, the NCUC reduced Nantahala's rates below the rates approved in the June 14, 1977, Order and required Nantahala to make refunds to its retail customers of the excess rates overcollected since 1977. The NCUC also ordered Alcoa to make such refunds as Nantahala was financially unable to make.

Nantahala, Tapoco, and Alcoa filed exceptions and notice of appeal to the Panel's decision of September 2, 1981. These parties also requested oral argument on their exceptions before the full NCUC. Following oral argument, the full NCUC issued its Order on January 28, 1982, affirming and sustaining in all respects the NCUC Order of September 2, 1981, and overruling the exceptions of Nantahala, Tapoco, and Alcoa.

On appeal by the Companies, the North Carolina Court of Appeals and the North Carolina Supreme Court affirmed the NCUC Orders of September 2, 1981, and January 28, 1982. *State ex rel. Utilities Commission* v. *Edmisten*, 65 N.C. App. 198, 309 S.E.2d 473 (1983); affirmed, 313 N.C. 614, 332 S.E.2d 397 (1985).

From the decision of the North Carolina Supreme Court, the Companies filed Notices of Appeal to the Supreme Court of the United States.

SUMMARY OF ARGUMENT

The NCUC files this brief as amicus curiae in support of the appellees. In their brief the appellees argue that the Orders of the NCUC do not violate the Federal Preemption Doctrine or the Commerce Clause of the United States Constitution.

The NCUC adopts the legal arguments of the appellees and the amicus curiae Town of Highlands, as set forth in their briefs.

The limited purpose of this brief is to set out for the Court what the NCUC decided in this case and why the NCUC decided as it did. The facts of the case are unique in the electric utility industry. Nantahala Power and Light Company is the wholly owned subsidiary of Alcoa. Since the early 1900's Alcoa has developed a power system, which includes Nantahala and Tapoco, in western North Carolina and eastern Tennessee to provide electricity for its aluminum plants in Tennessee. Alcoa's need for electricity is enormous. Alcoa is the largest customer by far of the Alcoa power system. Alcoa has dominated Nantahala and Tapoco for its own benefit as a customer of the Alcoa system and to the detriment of the retail customers of Nantahala.

The decisions of the NCUC have sought to rectify this corporate abuse. In setting rates for Nantahala and its retail customers, the NCUC employed accepted methodologies of jurisdictional and cost allocations. The NCUC sought neither to impinge upon the authority of the Federal Energy Regulatory Commission nor to place an impermissible burden on interstate commerce.

Despite the many attempts to characterize this case in Federal preemption terms, this is not a case about North Carolina versus Tennessee hydroelectric power. This is not a case about "first call." This case has nothing to do with whether power is generated in North Carolina or Tennessee.

It is essential to an understanding of the case that one understands the major role played by Alcoa, the parent of both Nantahala and Tapoco. The Appellants, as well as many of the *amici curiae* before this Court, have laid great emphasis on Alcoa, the customer. However, the NCUC dealt with Alcoa in Alcoa's primary role as the sole stockholder of Nantahala and Tapoco, and its manipulation of these two utilities for its own selfish interest, to the detriment of the customers of Nantahala. It was immaterial that one of these subsidiary utilities happened to be in the State of Tennessee. It is critical to recognize that any refund required to be paid was assessed against Alcoa-the-parent; Alcoa is a Pennsylvania corporation, and if refunds are required from it, the stockholders of Alcoa (the parent), wherever located, would be responsible for the payment of those refunds. There were no assessments against Tapoco or Alcoa-the-customer, and the NCUC nèver attempted to move one kilowatt of power from Tennessee to North Carolina or award any monetary damages which would affect our sister State, Tennessee.

If the Court will view Alcoa as the parent, the sole stockholder of Nantahala, the manipulator of its two puppet subsidiaries, Nantahala and Tapoco, it will have an understanding of the true significance of this case.

ARGUMENT

The Order of the NCUC issued September 2, 1981, made the following findings of fact:

1. Nantahala and Tapoco are public utilities under North Carolina law and are subject to the jurisdiction of the NCUC with respect to retail rates and service.

2. Both Nantahala and Tapoco are wholly owned subsidiaries of Alcoa.

3. Alcoa, the 100% owner of Nantahala and Tapoco, is a public utility under North Carolina law by virtue of its effect on the rates and service of Nantahala and Tapoco. N.C.G.S. 62-3(23)c.

4. The Nantahala and Tapoco electric facilities constitute a single, integrated electric system and are operated as such by, and as a coordinated part of, the Tennessee Valley Authority (TVA) system.

5. For purposes of setting Nantahala's rates in the proceeding, the Nantahala and Tapoco systems should be treated as one entity with respect to all matters affecting the determination of Nantahala's reasonable cost of service applicable to its North Carolina retail customers.

6. The New Fontana Agreement ("NFA"), executed by TVA, Alcoa, Nantahala and Tapoco, and the resultant 1971 Apportionment Agreement between Nantahala and Tapoco, have resulted in substantial benefits to Alcoa to the significant detriment of Nantahala's customers.

7. The roll-in methodology employed by the Intervenors [who represented the customers of Nantahala] should be used by the NCUC in making jurisdictional cost allocations and cost-of-service allocations.

8. Alcoa has so dominated certain transactions and agreements affecting its wholly owned subsidiary, Nantahala, that Nantahala has been left but an empty shell, unable to act in its own self interest, let alone in the interest of its public utility customers in North Carolina. (App. pp. 175a-179a).

Based upon these findings, the NCUC determined the rate base and expenses of the single Nantahala-Tapoco system, allocated the combined system costs between the retail public load in North Carolina and the industrial load of Alcoa in Tennessee, and set retail rates for Nantahala which resulted in a rate reduction from the retail rates approved in 1977. Nantahala was ordered to refund the excess rates it had collected from its retail customers. Alcoa was ordered to refund those amounts of excess revenues that Nantahala was financially unable to make. (App. pp. 233a-235a).

In its final Order entered on January 28, 1982, the NCUC overruled the exceptions of Alcoa, Nantahala, and Tapoco to the September 2, 1981, Order and made supplementary conclusions of law with respect to certain federal questions raised by the Companies in the oral argument before the full Commission. The NCUC concluded that the Order did not conflict with the exclusive federal licensing authority of hydroelectric power under Part I of the Federal Power Act, nor with the preemptive jurisdiction of FERC to regulate interstate wholesale electric rates; nor did the Order impose an unreasonable burden on interstate commerce. (App. pp. 237a-247a).

The Factual Basis of the NCUC Order: History and Development of the Integrated Alcoa Power System

The NCUC regulates four major electric utilities with respect to retail rates and service, including Nantahala Power and Light Company. Nantahala is unique among these companies, as an examination of the evidence before the NCUC will disclose. An understanding of the decision of the NCUC requires an examination of the electric power system in western North Carolina that was developed by Nantahala's 100% owner, Alcoa. The decision of the North Carolina Supreme Court and the Order of the NCUC of September 2, 1981, set out in detail the development of the Alcoa power system. (App. pp. 18a-32a) The facts may be summarized as follows:

In the early 1900's Alcoa came to the western North Carolina mountains to develop low-cost hydroelectric power for its aluminum reduction plant in Alcoa, Tennessee. As its source of hydroelectric power Alcoa acquired two public utilities, Tallassee Power Company ("Tallassee," later Carolina Aluminum, Inc., and now Yadkin, Inc.) and Knoxville Power Company (later Tapoco) in Tennessee. Tallassee owned several hydroelectric sites along the Little Tennessee River in North Carolina. By the 1920s Alcoa, through its subsidiaries, had acquired a substantial number of hydroelectric sites along the Little Tennessee River in North Carolina and Tennessee. Alcoa developed these sites primarily for the purpose of producing and transmitting electricity to its Alcoa, Tennessee, aluminum plant. (App. p. 18a)

In 1929 Alcoa created and incorporated Nantahala as another of its wholly owned subsidiaries in North Carolina. Nantahala was franchised as a North Carolina public utility to serve a six-county area in southwestern North Carolina. In time, Tallassee sold its undeveloped North Carolina sites to Nantahala, including the Fontana Dam site later developed by TVA. Between 1929 and 1941 Nantahala undertook token public service. In 1941 Nantahala obtained a certificate from the War Department to develop the Nantahala and Glenville projects on the upper reaches of the Little Tennessee watershed. Nantahala's stated justification for these projects was the huge electricity needs of Alcoa's aluminum plants in Tennessee. In its application for the certificate, Nantahala repeatedly referred to these projects as part of "the Alcoa power system" or "the system." (App. p. 19a).

Prior to 1941 both Nantahala and the Tennessee Valley Authority (TVA) were interested in developing a large hydroelectric site at Fontana on the Little Tennessee River in North Carolina. The project was to generate electricity both for Alcoa's aluminum production and for use by the public. Following a determination by the Federal Power Commission that the project would require a license from that agency under Part I of the Federal Power Act, Nantahala abandoned the project. (App. p. 19a).

In 1941 Alcoa and TVA entered into the Original Fontana Agreement ("OFA"). Nantahala was not a party to the agreement. Pursuant to this Agreement, Alcoa caused Nantahala to transfer the Fontana Dam site to TVA. The Agreement required the Alcoa system companies to convey the output from their generating plants to TVA in return for TVA power and

energy entitlements. The level and amount of power entitlements were dependent on the level of generation TVA controlled. In exchange for the companies' relinquishment of control over stream flow and production, TVA provided compensation power of 11,000 kW to the Alcoa system. During its 20-year term the OFA was never filed with the FPC as a tariff or rate schedule nor was its lawfulness ruled upon by the FPC. (App. pp. 20a-22a).

In October 1954 Nantahala and Alcoa entered into a contract which required Nantahala to make its excess power available for Alcoa's Tennessee plants and required Alcoa to provide power for Nantahala when Nantahala could not meet its public service load. At this time Nantahala's capacity and energy production were far in excess of its public service load. Nantahala's excess entitlements under the OFA were sold to Alcoa at "dump" prices. (App. pp. 21a).

In October 1954 Alcoa's wholly owned subsidiary, Knoxville Power, changed its name to Tapoco. Tapoco was then domesticated as a North Carolina corporation. (App. p. 24a).

In October 1954, Tapoco and its affiliate, Carolina Aluminum Company, filed a joint application with the FPC for a license to operate the "Tallassee project" along the Little Tennessee River in North Carolina and Tennessee. The joint application stated that the energy from the Tallassee project "is and will continue to be delivered to the Tennessee Valley Authority, which in turn delivers an equivalent amount of energy to the Aluminum Company of America at Alcoa, Tennessee, pursuant to the provisions of the Fontana Agreement and the supplemental agreement thereto dated August 14, 1941, and October 13, 1954,

respectively." The joint application also stated that after the exchange of energy between TVA and the Alcoa system pursuant to the Fontana agreement, "[a]ll the energy is used for aluminum production except for a small portion used for lighting in operators' villages." (App. p. 24a).

In 1955 Tapoco applied to the NCUC for a certificate of public convenience and necessity. This certificate is still in effect and has never been abandoned or modified. The certificate required Tapoco to supply power to Nantahala for the villages of Santeetlah and Tapoco, North Carolina. In 1955 Tapoco sold its Tennessee electric distribution system to the City of Alcoa and thereby freed itself of its Tennessee public load. Consequently, Tapoco's share of the TVA return power was devoted exclusively to Alcoa's aluminum production facilities. (App. pp. 25a-26a).

During the period 1941-1960 Nantahala sold over 80% of its total generating power to Alcoa at a price which was less than the cost of producing and distributing it. Yet Nantahala derived the greater part of its revenue from customers other than Alcoa, who consumed only 18% of its power and who were charged approximately twice as much per kWh as Alcoa was charged. The North Carolina Supreme Court determined that this sale at "dump prices" to Alcoa resulted in discrimination against Nantahala's retail customers. (App. pp. 26a-27a).

During the period 1950-1955 Nantahala expanded its facilities to provide additional power to Alcoa to meet Korean War aluminum demand. Nantahala has added no generating capacity to its system since 1957, notwithstanding its public load has increased. (App. p. 26a).

In 1960 Alcoa and TVA began the renegotiation of the Original Fontana Agreement. At the same time, Nantahala and Duke Power Company began negotiations whereby Nantahala would sell its distribution system to Duke while retaining its generating facilities. If the sale had been effected, Nantahala would have been allowed to abandon its public utility load. In 1963 the North Carolina Supreme Court reversed the NCUC's approval of the sale. (App. pp. 28a-29a).

The New Fontana Agreement (NFA), which took effect in January 1963, modified and partially superseded the OFA. Nantahala was a signatory to the NFA although it did not participate in the negotiations between Alcoa and TVA. Under the NFA there were the same mechanics of power coordination and exchange as in the OFA. TVA dispatched the operations of Tapoco's four plants and eight of Nantahala's largest plants and received all of the electrical output thereof. In return Nantahala and Tapoco would receive power entitlements from TVA, to be divided between the two companies as they saw fit. (App. pp. 28a-29a).

The NFA allowed Nantahala and Tapoco to divide the power from TVA as they saw fit. In 1963 the Alcoa-Nantahala Apportionment Agreement provided that Nantahala was to receive each month a variable of the larger of one-twelfth of its annual primary energy capability of 360 million kWh or its actual generation (which was 424 million kWh annually). The 1963 Agreement fixed no capacity or demand limitation upon Nantahala's use of the energy returned. Alcoa was to pay Nantahala the sum of $89,200 annually as compensation for allowing TVA to operate Nantahala's projects. Unlike the 1954 Alcoa-Nanta-

hala Agreement under the OFA, the 1963 Agreement did not require Alcoa to satisfy any power deficiency experienced by Nantahala in meeting its public load. (App. p. 30a).

By 1971 Nantahala's public load had grown to the point where it had no more excess energy to sell to Alcoa. To meet the needs of its growing public load, Nantahala looked to TVA. At the urging of TVA, Nantahala and Tapoco executed the 1971 Apportionment Agreement, in which Nantahala's share of the NFA power entitlements was fixed at 360 million kWh annually, which was its primary energy capability. Nantahala entered into a contract to purchase additional power from TVA. As a result of this agreement, Nantahala was required to pay a charge for the demand of its system above 54,300 kW at any instant. The 1971 Agreement did not retain the provision in the 1963 Agreement whereby Alcoa paid Nantahala $89,200 annually in compensation for TVA's control of Nantahala's facilities. The 1971 Apportionment Agreement was not filed with the FPC until 1980. (App. pp. 30a-31a).

Since 1971 Nantahala's return power entitlements from TVA have not been sufficient to meet its public load, even though its actual generation exceeded its public load during the 1975 test year. As a result, Nantahala has had to purchase higher cost power from TVA. (App. p. 32a).

Based upon the evidence before it, the NCUC found and concluded that the Nantahala-Tapoco electric facilities constitute a single integrated electric system and should be considered as such for retail ratemaking purposes. In so deciding, the NCUC considered the following evidence: Nantahala and Tapoco are both

wholly owned subsidiaries of a single corporate parent, Alcoa. The electric facilities of Nantahala-Tapoco are mostly located on the Little Tennessee River and its tributaries in western North Carolina. The Nantahala and Tapoco facilities are located in contiguous areas and are physically interconnected with each other. Both companies are interconnected with TVA. Power can be dispatched and transmitted from the facilities of one to the facilities of the other. The Original Fontana Agreement and the New Fontana Agreement, both of which were negotiated with TVA by Alcoa, treat the facilities of Nantahala and Tapoco without discrimination and make them an integrated part of, and subject them to coordination by, the TVA system. Pursuant to these agreements TVA receives the output of all of the hydro resources of both Nantahala and Tapoco, except for three small units of Nantahala. These agreements also required Tapoco and Nantahala to turn over to TVA the control of production and stream flow. Accordingly, TVA determines for Tapoco and Nantahala, as a single entity, both electric generation and stream flow and operates them as a coordinated part of TVA's own system. In turn, Tapoco and Nantahala jointly receive back from TVA certain entitlements of power which they divide between themselves by the 1971 Nantahala-Tapoco Apportionment Agreement. (App. pp. 41a-44a; 180a-182a).

Nantahala was designed to operate as an integral part of a larger utility system, and its projects were developed in accordance with Alcoa's aluminum production needs rather than the needs of its public load. In fact, the greater part of Nantahala's capacity was added before there was a significant public load. Since

the mid-1950s no significant capacity has been added despite the continued growth of Nantahala's public load. (App. p. 42a).

The Benefits to Alcoa and the Detriment to Nantahala and to Nantahala's Retail North Carolina Customers Resulting from the Domination by Alcoa of the Integrated Power System.

The NCUC found that Alcoa has so dominated Nantahala that Nantahala was unable to act in its own self interest or in the interest of its public utility customers in North Carolina. Because of this corporate dominance, the various agreements executed by Alcoa with TVA, and among Alcoa, Tapoco, and Nantahala, resulted in substantial benefits to Alcoa and significant detriment to Nantahala. The agreements show that the power system developed by Alcoa since the early days of the 20th century was designed to benefit primarily the needs of the Alcoa aluminum plants in eastern Tennessee.

These benefits and detriments were discussed by the NCUC in detail. The North Carolina Supreme Court summarized them as follows:

> In some twenty pages of its rate reduction order, the Commission exposed and "fleshed out" the extensive network of detriments and inequities to Nantahala and its customers embedded in the terms of the NFA and 1971 Apportionment Agreement. In essence, the Commission found that a disproportionate amount of the capacity and energy resources of the combined Nantahala-Tapoco system, perfectly usable by the load characteristics of the Nantahala public load, were traded away to reform the TVA return entitlements to fit the needs and characteristics of an aluminum smelting and fabrication operation. Because Nantahala is structured, operated, and treated as an integral unit of the combined system, rather than as a stand-alone company, the detriments it incurs under the integrated system's power supply contracts result in concealed benefits flowing to Tapoco, and ultimately to its parent and sole customer, Alcoa. While "costs" charged to the combined system under these contracts might be considered objectively fair and reasonable from the wholesale perspective, the public customers of Nantahala were found to have fared badly when that utility was artificially separated out of the unified system for allocation purposes, and then forced to bear the added responsibility for costs of purchased power from TVA. (App. p. 57a).

1. Concealed Benefits of the 1971 Apportionment Agreement

A full discussion of the detriments to Nantahala and the benefits to Alcoa arising out of the NFA and the 1971 Apportionment Agreement may be found in the Order of the NCUC. (App. pp. 182a-205a). For example, the NCUC found that, under the 1963 Agreement, Nantahala received annually an average of 426 million kWh as NFA energy entitlements. There was no demand limitation on Nantahala's use of its return power entitlements. Under the 1971 Agreement, however, which was devised by Alcoa power consultant, George Popovich, Nantahala received only 360 million kWh annually. Consequently, Nantahala was deprived of an average of 66 million

kWh annually. The NCUC concluded that this "detriment to Nantahala constitutes a benefit to Tapoco that is passed on to Alcoa." (App. p. 185a).

With respect to the quantity of Nantahala's peaking capacity: the 1963 Agreement placed no demand limitation on Nantahala's use of its return power entitlements. Under the 1971 Agreement, as devised by Mr. Popovich, Nantahala was assigned a peaking capacity of 54,300 kW, although a 1960 study had computed Nantahala's capacity at 85,400 kW under the most adverse water conditions. As a result, anytime that Nantahala provided a customer demand in excess of 54,300 kW, it paid a monthly demand charge to TVA for all power over that limitation. The NCUC found Nantahala's actual capacity to be 81,800 kW. The NCUC concluded that "[d]emand costs imposed on Nantahala for use of capacity between its assigned capacity of 54,300 kW and its actual capacity of 81,800 kW, would represent an expense to Nantahala and, thus, a savings to its New Fontana Agreement sister, Tapoco, since the capacity constraints for the TVA return entitlements are jointly shared by them under the New Fontana Agreement. Tapoco's savings are passed on to Alcoa so as to become Alcoa savings, i.e., a concealed benefit." (App. p. 186a).

The NCUC also determined that the 1971 Apportionment Agreement gave no credit for Nantahala's upstream benefits to Tapoco, which arise from the fact that water stored by Nantahala upstream can be released to flow downstream and be used by Tapoco for the production of electricity. The NCUC computed the value of this benefit at 37,668,000 kWh annually as an upstream benefit from Nantahala to Tapoco. Under the 1971 Agreement, Nantahala received no

credit for this benefit to Tapoco, which accrued to Tapoco and, in turn, to Alcoa. (App. pp. 189a-190a).

The NCUC further found that the 1971 Apportionment Agreement as devised by Alcoa consultant Popovich did not consider the proper value to Nantahala of the fact that the Nantahala, Tapoco and TVA systems are interconnected. The NCUC Order stated:

> . . . Interconnection is of considerable value to TVA completely aside from the fact that Nantahala's rate base includes in it certain assets devoted to the interconnection, which assets are entitled to earn a rate of return. Because Nantahala is not an isolated system, it should be receiving the usual benefits that accrue from coordinated operation. Yet, Nantahala does not receive the usual benefits of an interconnected and coordinated system. (App. p. 193a).

In reaching this determination, the NCUC relied on Alcoa documents, introduced by the customers, which revealed Alcoa's recognition of the value to TVA of the integrated operations. For example, one Alcoa memorandum stated:

> There is a strong feeling among the Engineering Department, particularly Messrs. Gnuse, Tompkins, Eagleton, Popovich and others, that the value to TVA of integrated operation is much greater in 1960 than it was in 1941 at the time the contract was negotiated. They have argued that because of this, TVA should be willing to renegotiate

the entire Fontana Agreement recognizing the present inequities. . . (App. p. 194a).

The NCUC calculated that Nantahala's upstream benefit to TVA was 70,956,000 kWh. Nantahala received no credit for this benefit in the 1971 Agreement.

The NCUC summarized the detriment to Nantahala from the 1971 Apportionment Agreement by totaling the annual kWh which Nantahala contributed to the combined power system and for which no credit was given. The NCUC determined that Nantahala was deprived of 200,224,000 kWh annually. The NCUC further noted that Nantahala "received no credit for its peaking capacity of 27,500 kilowatts over the 54,300 kilowatts assigned to it, for which Nantahala must pay demand charges to TVA when monthly demand exceeds assigned capacity." (App. p. 196a).

The NCUC concluded:

> Now that considerably more of the various detriments to Nantahala have been exposed and fleshed out, it is apparent that the 1971 Apportionment Agreement works an extensive injustice on Nantahala and its public ratepayers, the gravity of which far exceeds even that envisioned by the [North Carolina] Supreme Court. (App. p. 197a).

2. Concealed Benefits of the New Fontana Agreement

A full discussion of the concealed benefits flowing from Nantahala to Alcoa by virtue of the New Fontana Agreement may be found in the NCUC's Order of September 2, 1981, (App. pp. 197a-215) and in the opinion of the North Carolina Supreme Court (App. pp. 63a-65a). In summary, the NCUC found these concealed benefits to be "entirely different" from the

benefits of the 1971 Apportionment Agreement. The NCUC Order stated:

> The basic inequity to Nantahala arising out of the NFA is that the energy entitlement returned to Nantahala and Tapoco from TVA is structured to meet Alcoa's demand for a certain amount of stable electricity for purposes of aluminum production rather than a demand for a public load. Consequently, the NFA returns an average of 218,300 kilowatts of energy at a high load factor with minimal peaking deviation, which load is principally designed to service Alcoa's pot-lines and other production electrical requirements. Even the interruptible and curtailable energy entitlement returned to Tapoco-Nantahala is in increments of wattage that conform to the demands of a pot-line so that, if power is interrupted or curtailed, Alcoa can respond by cutting out a particular pot-line. (App. p. 197a).

The NCUC compared the demand of Alcoa with that of Nantahala. Nantahala has the fluctuating demand for energy which has peaks and valleys and which is typical of a public service load. The NCUC noted that Nantahala needed peaking capacity and that its generation projects had that capacity, but that such peaking capacity was traded away to TVA by the New Fontana Agreement. (App. p. 198a). The evidence further showed that Alcoa reaped "enormous benefits" through the improvement of the availability of Tapoco's secondary energy production from a level of 42% average curtailment to an average curtailment rate of only 8%. (App. 198a).

Alcoa was in direct control of the negotiations with TVA that resulted in the New Fontana Agreement. (App. p.198). The NCUC examined the reasons why the NFA was designed so exclusively to meet Alcoa's needs, to the detriment of Nantahala's public load. It concluded that during the NFA negotiations between Alcoa and TVA the parties contemplated the sale of Nantahala's distribution system to Duke Power Company. "By the sale to Duke, Nantahala would have been left with its generation but would have been without a public service load. Nantahala would then have taken its NFA entitlement and delivered it all to Alcoa. Accordingly, the power Nantahala would have gotten under the NFA would have been satisfactory for delivery to Alcoa irrespective of quantity and design." (App. pp. 198a-199a). The NCUC approved the sale to Duke, but this Order was reversed by the North Carolina Supreme Court in 1963 and the sale never took place. By the time the North Carolina Supreme Court handed down its decision, the NFA had been executed. The NFA was never modified or amended, however, to take into account that the sale to Duke did not take place.

The Roll-In and the Allocation Methodologies

Having determined that Nantahala and Tapoco constitute a single, integrated power system, the NCUC then proceeded to set reasonable rates for Nantahala by employing the roll-in methodology, whereby the rate base, revenues, and expenses of Nantahala and Tapoco were added together, and the combined system assigned the rate of return approved for Nantahala alone in the 1977 proceeding. Next, the combined system cost of service was allocated between the public load customers in North Carolina and the industrial load customer (Alcoa) in Tennessee. The allocation methodology proposed by the Companies assigned customer costs by using the entitlements of the New Fontana Agreement and the 1971 Apportionment Agreement. The methodology proposed by all of the intervenors, including the Attorney General, allocated cost responsibility to the Nantahala retail public load on the basis of the percentages of the combined system's power and energy resources, including Nantahala's TVA purchases, required to serve that load. (App. p. 55a).

The NCUC concluded that the inequities arising out of the New Fontana Agreement and the 1971 Apportionment Agreement should not be used as a basis for cost allocation and rejected the Companies' allocation methodology. The NCUC stated in its order:

> Summarizing the foregoing inequities to Nantahala which result from the New Fontana Agreement, it can be stated that the TVA return entitlement was entirely designed for Alcoa's industrial load and was not suitable for Nantahala's public service responsibilities. Nantahala needed peaking capacity and had peaking capacity from its own generating stations, yet Nantahala gave up that capacity with the result that it must buy high cost power from TVA to meet its peaking responsibilities. The extra costs thus incurred by Nantahala inure to the benefit of Alcoa. For instance, by the 1963 Alcoa-Nantahala Apportionment Agreement, even Alcoa recognized, in fact, the unfairness to Nantahala produced by the NFA and agreed to pay an annual cash settlement of $89,200,

to Nantahala to offset some of the inequities. (App. p. 202a).

The NCUC adopted the cost allocation methodology propounded by the intervenor customers. The methodology used by the NCUC was neither unique nor revolutionary, but is traditionally employed by the NCUC in apportioning the total system costs of any multijurisdictional investor-owned electric utility, e.g. Duke Power Company or Carolina Power & Light, both of which provide wholesale and retail service in two states.

Of critical importance was the inclusion or exclusion of Alcoa's power purchases from TVA in the combined system cost of service. The NCUC accepted the contentions of the intervenor customers that the direct industrial purchases that Alcoa made from TVA were not properly a utility function of either Tapoco, Nantahala, or the combined utility system of both, and therefore was not properly includable in the cost of service allocation. These purchases, which amounted to $31 million, were allocated entirely to Alcoa. In deciding to exclude these purchases, the NCUC determined that the TVA power purchased by Alcoa was not integrated with the combined electric system. The evidence showed, for example, that the TVA power never entered the combined system. The evidence showed, at most, that if Tapoco had any contact with the TVA purchases, such contact amounted only to transforming and switching. The TVA power retained its identity as Alcoa power. (App. p. 211a).

In support of its decision to exclude the TVA purchases from the combined system costs, the NCUC examined the contract between TVA and Alcoa for the power purchases. The NCUC found that the terminology of the contract was not suitable for a public utility load, which needs variable amounts of energy, but rather was suitable only for a specific industrial customer having stable needs. (App. p. 214a).

The NCUC Order stated:

> Alcoa is a gigantic energy consuming entity nationwide and its impact on western North Carolina is likewise enormous. If the Alcoa, Tennessee, load that is purchased from TVA were to be assigned as a function of the Nantahala-Tapoco system, the impact of that load on the system would be so enormous as to warp and twist the costing technique of the entire system. Indeed, if the Nantahala-Tapoco system tried independently to service the Alcoa-Tennessee load, it would have to double its system size. Yet no effort has been made by the system to do that. Neither Nantahala or Tapoco has built a facility in over 20 years. Alcoa is entirely dependent upon TVA for its supplemental load. (App. p. 215a).

The primary cost allocation issues specifically concerned the development of appropriate demand and energy cost allocation factors. In summary, the Commission concluded that 24.60% of all Nantahala-Tapoco unified system demand related costs and 24.51% of all Nantahala-Tapoco unified system energy costs should be assigned to the system's North Carolina retail operations. (App. pp. 215a-221a).

The Rate Reduction and the Liability of Alcoa

Having found that Alcoa's dominance of its wholly owned subsidiary resulted in substantial benefits to

Alcoa and significant detriment to Nantahala and its retail ratepayers, the NCUC Order of September 2, 1981, reduced Nantahala's rates to reflect the cost of service of the combined system, required refunds to Nantahala's customers of the excess rates collected by Nantahala from its customers, and required Alcoa to make the refunds to the extent that Nantahala was financially unable to do so. In so deciding, the NCUC sought to fix just and reasonable rates for Nantahala and its retail customers and to rectify the corporate abuse by Alcoa of its power system in western North Carolina.

In imposing the refund obligation upon Alcoa as well as Nantahala, the NCUC "pierced the corporate veil" to hold the parent Alcoa responsible for its detrimental dominance of the Alcoa power system. Alcoa's single-minded development of the hydropower sites in western North Carolina resulted in Alcoa's assigning exclusively to itself the least expensive power of the system, while the more expensive power was relegated to Nantahala's public load. The adverse impact on Nantahala's retail rates was enormous.

CONCLUSION

The North Carolina Utilities Commission never changed any rate set by the Federal Energy Regulatory Commission. The North Carolina Utilities Commission Order never moved one kilowatt of power from Tennessee to North Carolina or caused any rate for electric power to change in Tennessee. The North Carolina Utilities Commission simply exercised its power and duty to set fair rates for North Carolina retail customers. Choosing the appropriate allocation method of the roll-in for Nantahala is comparable to

using the summer coincident peak allocation method in North Carolina Duke rate cases, whereas, the Federal Energy Regulatory Commission uses the twelve-month coincident peak. Neither methodology interferes with FERC's exclusive jurisdiction under the Federal Power Act.

This case is unique because Alcoa-the-parent totally manipulated its wholly owned subsidiary Nantahala. The manipulation resulted in vast benefits to the parent and substantial detriment to the retail customers of Nantahala. The case simply requires Alcoa-the-parent to be responsible for the refunds because Alcoa-the-parent was responsible for the unjust charges to Nantahala's customers.

As pointed out in the amicus brief of New England Electric System (NEES), Alcoa is not a typical electrical utility holding company. In fact NEES takes pains to point out that Alcoa may not adequately present the view of other utility holding companies "because Alcoa's primary business is not as an electric utility and it is not subject to comprehensive regulation under the Holding Company Act, the Federal Power Act, and state utility law as are NEES and its subsidiaries." Because of Alcoa's domination and manipulation of its two utility subsidiaries, it is necessary to find that there is only one unified electric system and that the roll-in is the proper mechanism to allocate that system's costs.

For the reasons stated, the decision of the North Carolina Supreme Court below should be affirmed.

Respectfully submitted,

WILSON B. PARTIN, JR.
Deputy General Counsel
(Counsel of Record)
NORTH CAROLINA UTILITIES COMMISSION
430 North Salisbury Street
Post Office Box 29510-Dobbs Building
Raleigh, North Carolina 27626-0510
(919 733-3969

No. 85-568

(19)

IN THE

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF FOR THE TOWN OF HIGHLANDS, NORTH CAROLINA, AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

CORRECTED COPY

RODERIC G. MAGIE
Mayer & Magie
P.O. Box 750
Highlands, N.C. 28741
(704) 526-3731

JAMES N. HORWOOD
Counsel of Record
CYNTHIA S. BOGORAD
P. DANIEL BRUNER
Spiegel & McDiarmid
1350 New York Avenue, N.W.
Washington, D.C. 20005-4798
(202) 879-4000

Attorneys for the Town of Highlands, North Carolina

February 22, 1986

41PP

No. 85-568

In The

Supreme Court of the United States

October Term, 1985

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF FOR THE TOWN OF HIGHLANDS, NORTH CAROLINA, AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

Roderic G. Magie
Mayer & Magie
P.O. Box 750
Highlands, N.C. 28741
(704) 526-3731

James N. Horwood
Counsel of Record
Cynthia S. Bogorad
P. Daniel Bruner
Spiegel & McDiarmid
1350 New York Avenue, N.W.
Washington, D.C. 20005-4798
(202) 879-4000

Attorneys for the Town of Highlands, North Carolina

February 22, 1986

QUESTIONS PRESENTED

1. Is a state preempted from setting a utility's rates to retail customers by "rolling-in" all costs of two integrated utilities (including those costs incurred under FERC-filed rate schedules) and allocating those combined costs to the public on the basis of load, so as to require a utility and its sole stockholder, rather than the utility's ratepayers, to bear the costs of the stockholder's abuse and manipulation of its subsidiary for the stockholder's benefit, where FERC explicitly recognized that the state's determination regarding roll-in may differ from its own, and where FERC itself did not follow the FERC-filed rate schedules in setting that utility's rates to wholesale customers?

2. Is a state precluded by the Commerce Clause from setting retail rates in the above-described manner and placing refund responsibility on the utility and its stockholder, where the sole stockholder is an industrial corporation with a plant located in another state and chooses to attribute the refunds imposed on it to its costs of production in that other state?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

COURT CASES

Page

COURT CASES (Continued)

IN THE

Supreme Court of the United States

October Term, 1985

No. 85-568

NANTAHALA POWER AND LIGHT COMPANY, TAPOCO, INC., AND ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, *ex rel.* UTILITIES COMMISSION; LACY H. THORNBURG, ATTORNEY GENERAL, *et al.*,

Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF FOR THE TOWN OF HIGHLANDS, NORTH CAROLINA, AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

The Town of Highlands, North Carolina, purchases power from Nantahala Power and Light Company ("Nantahala") at wholesale. Highlands was an active participant in the roll-in proceedings at the Federal Energy Regulatory Commission ("FERC") which paralleled the North Carolina Utility Commission ("NCUC") proceedings here appealed.[1] Aluminum Company of America ("Alcoa") and some of its allies, most

[1] *Nantahala Power and Light Co.*, Opinion No. 139, 19 F.E.R.C. ¶ 61,152, *reh'g. denied*, Opinion No. 139-A, 20 F.E.R.C. ¶ 61,430, Opinion No. 139-B, 21 F.E.R.C ¶ 61,222 (1982), *aff'd*, *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984). Highlands also is a key participant in the ongoing litigation before the FERC concerning Appellants' subsequent efforts to contractually separate Nantahala and Tapoco, Inc. *Tapoco, Inc.*, 30 F.E.R.C. ¶ 63,050, *clarified*, 31 F.E.R.C. ¶ 63,056 (1985) (exceptions pending).

egregiously the Federal Amici,[2] seriously mischaracterize the FERC decisions which are so critical to the issues raised before this Court. Highlands, as a political subdivision of the State of North Carolina, files this brief pursuant to Supreme Court Rule 36.4.

INTRODUCTION AND COUNTERSTATEMENT OF THE CASE

Alcoa and its supporters labor hard to present this case as something it is not. This is not a case of conflict between retail electric regulation in Tennessee and North Carolina, or a case in which North Carolina sought to benefit its electric consumers at the expense of Tennessee consumers. It *is* a case in which the NCUC has protected the retail public load of what it found to be an integrated Nantahala/Tapoco electric system from exploitation by the system's sole shareholder, Alcoa, which had transferred low-cost power to its aluminum plant in Tennessee.

Nor do the North Carolina decisions conflict with any order of the FERC. FERC Opinion No. 139 did *not* allocate costs between affiliated utilities or between states. The FERC addressed the New Fontana Agreement ("NFA") and the 1971 Apportionment Agreement only in the context of setting Nantahala's rates to three *wholesale* customers. The FERC's exercise of discretion to reject rolled-in ratemaking for Nantahala's wholesale rates does not preempt the NCUC from using roll-in for Nantahala's *retail* rates. The FERC's finding of no abuse of the Federal Power Act does not preempt the NCUC from determining that the affiliated North Carolina public utilities — including Alcoa itself — have abused North Carolina law. The FERC cannot preempt the NCUC now through mischaracterizations of Opinion No. 139 in a brief; nor can Alcoa do so by choosing to attribute its refund liability to the cost of electricity at its Tennessee plant.

[2] The Solicitor General of the United States and the Federal Energy Regulatory Commission. Tennessee, Edison Electric Institute ("EEI"), and New England Electric System ("NEES") also filed briefs supporting Alcoa.

Conspicuously absent from the briefs of Alcoa and its allies is the long history of Alcoa's manipulations to obtain low-cost hydroelectric power at the expense of the public, discussed by the North Carolina Supreme Court (Jurisdictional Statement Appendix ("App.") 18a-32a). The Nantahala and Tapoco hydroelectric systems are the end result of more than 40 years of corporate organizations, acquisitions and name changes, and transfers of hydroelectric properties among Alcoa, its various subsidiaries and the Tennessee Valley Authority ("TVA"), maneuverings that appropriated the least-cost generation for Alcoa's smelter (*id.* at 18a-20a, 23a-24a, 25a-26a). Alcoa sought preferred access to even Nantahala's hydroelectric power by purchasing most of Nantahala's output at rates lower than Nantahala's costs *and* lower than its rates to other retail customers. The North Carolina courts previously ruled that this was unlawful discrimination. *Utilities Comm'n* v. *Mead Corp.*, 238 N.C. 451, 78 S.E.2d 290 (1953), discussed at App. 26a-28a. At the time it negotiated the NFA, Alcoa sought to obtain all of Nantahala's major hydroelectric generation for its own use by selling the distribution system. The North Carolina Supreme Court halted the sale. *Utilities Comm'n* v. *Haywood Electric Corp.*, 260 N.C. 59, 131 S.E.2d 865 (1963), discussed at App. 28a-29a. In the 1960's, Nantahala's public load grew substantially, but Alcoa added no generation to the Nantahala system (*see* App. 26a-27a). In 1971, Alcoa ceased purchasing directly from Nantahala, but indirectly appropriated part of Nantahala's generation, through Tapoco, in the 1971 Apportionment Agreement (*id.* at 30a-31a). Nantahala was left to obtain the growing amounts of supplemental power it needed to serve its public load from TVA, whose rates escalated dramatically during the 1970's (*id.* at 31a-32a).[3] Throughout this history, Alcoa engaged in a largely successful effort to evade Federal regulation of its subsidiaries' hydroelectric projects and of the bulk power contracts with TVA, and with and among its subsidiaries, which maximized the usefulness of the Nantahala/Tapoco

[3] Compare Alcoa Br. 6.

system resources for aluminum smelting (*id.* at 19a-20a, 21a-22a, 29a, 30a, 31a).[4]

In the orders at issue here, the NCUC looked through the structure created by Alcoa and found a single integrated Nantahala/Tapoco system, and domination of Nantahala for the shareholder's benefit and to the injury of Nantahala's ratepayers. To remedy this abuse, the NCUC combined the two systems for ratemaking purposes, and allocated costs to the public using the methodology commonly used for utilities that operate in more than one state. The NCUC pierced the corporate veil between Nantahala and Alcoa to hold the parent responsible for its injury to the public. *See infra* at page 24.

In the parallel wholesale rate case,[5] the FERC held that Nantahala's arrangements with its affiliates did not compel

[4] Alcoa (Br. 6 n.9) asserts that its refusal to file the 1971 Apportionment Agreement as a FERC rate schedule until 1980 was merely based on a "technical dispute." To the contrary, Tapoco's October 9, 1980 letter to the FERC filed the contract "under protest", asserting (at 1-2): "This agreement does not provide for any sales for resale or for the transmission of electricity in interstate commerce." The Commission's 1981 order accepting the contract for filing effective in 1971 reflects that the services commenced in 1971 (App. 265a), not the alleged earlier availability of the contract in the files as Alcoa claims. Opinion No. 139 held that the 1971 contract and an earlier (1963) apportionment contract (which, like the Original Fontana Agreement, was never filed) should have been filed as rate schedules when entered into (App. 299a).

[5] Although Alcoa now argues that the NCUC proceedings were *ultra vires* insofar as they addressed the NFA and 1971 Apportionment Agreement (Br. 9-10), Alcoa's July 10, 1978 "Answer and Request for Dismissal . . ." of Highlands' roll-in complaint in FERC Docket No. EL78-18 argued that the *FERC* investigation requested by Highlands "would be repetitive of the recent investigation by the North Carolina Utilities Commission. . ." (at 43). Alcoa further attempted to prevent FERC review by stating (at 5):

> Sales to the wholesale customer class, of which Highlands is a member, represent a very small portion of Nantahala's sales of electricity. . . . The North Carolina Utilities Commission, which is the state regulatory body charged with protecting the interest of Nantahala's retail customers, has determined that the contractual arrangements through which Nantahala supplies its wholesale and retail electrical load are just and reasonable. This Commission should respect the decision of the NCUC as that of a responsible regulatory body and should defer to that decision under principles of comity between state and federal regulation.

Alcoa now characterizes the NCUC's 1977 order as deferring to "FERC-regulated rate schedules" (Br. 9), even though the 1971 Apportionment Agreement was not filed with FERC until three years later.

roll-in to set rates to Nantahala's wholesale customers. Opinion No. 139, App. 290a-295a; Opinion No. 139-A, App. 304a-308a. The FERC explicitly acknowledged the NCUC's earlier use of roll-in to set Nantahala's retail rates as based on "criteria which each ratemaking authority may deem relevant." Opinion No. 139-A, App. 305a. The Fourth Circuit affirmed the FERC's roll-in determination as an exercise of ratemaking discretion. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342, 1348 (4th Cir. 1984). In the context of determining whether wholesale roll-in was appropriate under the applicable FERC standard, the FERC considered Nantahala's past and then current contracts with affiliates to "examine any intercorporate transactions . . . which might distort customer cost responsibility." Opinion No. 139, App. 293a. *See also id.* at 291a-292a. The FERC did *not* approve or modify the NFA or the 1971 Apportionment Agreement to determine a just and reasonable allocation of costs between North Carolina and Tennessee or between Tapoco and Nantahala.[6] The FERC stated explicitly that the decision did not affect Tapoco's entitlements under those rate schedules. Opinion No. 139-A, App. 309a. Rather, in determining the rates for Nantahala's wholesale customers, the FERC found that Nantahala inexplicably had surrendered the greater benefits of an earlier (unfiled) Nantahala-Alcoa

[6] Nowhere in Opinion No. 139 or 139-A did FERC make a finding that the 1971 Apportionment Agreement (with the exception of the unfair energy entitlements) was "just and reasonable", notwithstanding Alcoa's assertions to the contrary. *See, e.g.*, Alcoa's purported description (without citation) of Opinion Nos. 139 and 139-A (Br. 24). Also deceptive is Alcoa's attempt to strain the Administrative Law Judge's ultimate conclusion with regard to the justness and reasonableness of the Nantahala *wholesale* rates he recommended (Alcoa Br. 8-9).

apportionment contract without consideration, and that the 1971 Apportionment Agreement was unfair to Nantahala. It therefore set rates as if Nantahala had received more TVA energy than it was entitled to receive under the 1971 Agreement. Opinion No. 139, App. 295a-298a; Opinion No. 139-A, App. 309a, 311a. The FERC characterized its evaluation of "the prudence of the costs incurred by Nantahala" as an exercise of its authority to set just and reasonable wholesale rates. Opinion No. 139-A, App. 312a.

SUMMARY OF ARGUMENT

With regard to the Supremacy Clause, Alcoa and its allies are asking the Court to resolve a question that is in no way presented by the facts here. Most of them portray the NCUC's roll-in methodology as seeking "to change the precise allocations established by the Commission in the course of its review of the interstate arrangements" (Fed. Br. 9). Alcoa goes so far as to frame the question presented as whether a retail rate commission can "reject the interstate wholesale cost and power allocations that FERC . . . in this case actually approved" (Br. i). Alcoa and its allies have fundamentally mischaracterized Opinion No. 139.

Under the Federal Power Act, the FERC has exclusive jurisdiction over "the sale of electric energy at wholesale in interstate commerce" (16 U.S.C. §824(b)(1)); a wholesale transaction is "a sale of electric energy to any person for resale" (16 U.S.C. §824(d)). One type of wholesale electric rate schedule is a bulk power exchange arrangement among utilities in which each utility both buys and sells electricity. The NFA and 1971 Apportionment Agreement are agreements of this kind. In setting the retail rates of a utility that incurs costs under such an agreement, a state commission cannot modify, and must give effect to, the "filed rate" approved or modified by the FERC. However, in evaluating the justness and reasonableness of this type of transaction, the FERC normally does not review the question of a buyer's prudence in entering the transaction, or the reasonableness of obtaining the power in question as opposed to power from any

other source. It leaves those questions to the state ratemaking authorities when the utility attempts to pass the costs through to its retail customers, and defers such questions on the wholesale side until the utility attempts to pass the costs through to wholesale customers.

A sale for resale to full or partial requirements customers is very different from bulk power exchange transactions. The FERC's role in evaluating a utility's wholesale rates is largely analogous to a state commission's role in setting retail rates. Ratemaking determinations of one commission generally do not bind the other in this context. For example, there is no argument that the NCUC was required to follow the FERC by disallowing Nantahala's automatic adjustment clause for purchased power.

In Opinion No. 139, the FERC reviewed the bulk power arrangements in the course of determining whether roll-in was appropriate for setting rates to Nantahala's wholesale customers, *not* in its role as regulator of bulk power exchanges and allocator of costs between states. It explicitly found the arrangements to be unfair to Nantahala, but refused to modify the contractual allocation of power between Nantahala and Tapoco. Instead, FERC ordered Nantahala to assume additional entitlements for purposes of setting wholesale rates. These wholesale ratemaking determinations are not the kind of determinations that bind states in their retail ratemaking. Indeed, in acknowledging the NCUC's earlier roll-in determination, Opinion No. 139-A made clear that the FERC had no intention of binding the NCUC to its ratemaking methodology.

In order to make Opinion No. 139 fit their preemption mold, Alcoa and the supporting amici are forced to choose (or alternate between) one of three tactics. Some (most clearly, the Federal Amici) simply misstate the holdings of Opinion No. 139. Others develop a novel "imputed filed rate" doctrine, arguing that the FERC allocated costs between utilities and states even though it said it was not doing so. One amicus (NEES) acknowledges the actual nature of Opinion No. 139, but argues that because the FERC did not modify the agreements, the NCUC was bound by the letter of the agreements

even though the FERC itself departed from them in setting Nantahala's wholesale rates. Unless Opinion No. 139 is completely re-written now, the North Carolina decisions can be preempted only by altering radically the filed rate doctrine and the balance of federal and state ratemaking authority, declaring Opinion No. 139 and numerous other FERC decisions in violation of the Federal Power Act, and committing a grievous injustice with regard to 93% of Nantahala's customers.

The Commerce Clause argument of Alcoa and its allies is based on the erroneous premise that the NCUC allocated costs to Tapoco and to Tapoco's Tennessee customer, Alcoa. To the contrary, North Carolina explicitly held that Alcoa, as Nantahala's dominating stockholder and a North Carolina public utility, was responsible for the adverse results of its manipulation of its North Carolina public utility subsidiaries. That Alcoa may choose to allocate the retail refunds to its smelter for internal accounting purposes, and that the smelter happens to be located in Tennessee rather than North Carolina, does not implicate the Commerce Clause. The situation here is no different from instances where ratemaking authorities have disallowed a utility's costs, for example, those associated with a coal or construction contract, on grounds of prudence. The NCUC's orders should be upheld as even-handed regulation having only an incidental effect on interstate commerce.

ARGUMENT

I. THE NCUC'S ORDERS DO NOT VIOLATE THE SUPREMACY CLAUSE

A. FERC Opinion No. 139 Does Not Preempt The NCUC's Treatment of Federally-Filed Rate Schedules

What is most revealing about the preemption arguments of Alcoa and its allies is their inconsistency regarding what allocation of TVA entitlements they believe the NCUC was required to use in setting retail rates. NEES argues (Br. 12, 18)

that the NCUC is required to use the FERC-filed rate — the 1971 Apportionment Agreement — in setting retail rates. Apparently now recognizing that it would be absurd to require the NCUC to adhere to a contract the FERC has found unfair and from which the FERC has protected wholesale ratepayers, Alcoa and its other allies largely adopt a novel reading of the filed rate doctrine, or attempt to completely rewrite Opinion No. 139, in order to argue that the NCUC was bound to apply to retail ratemaking the same entitlements that the FERC required Nantahala to impute for setting rates to wholesale ratepayers. Alcoa now argues that even though Opinion No. 139 did not modify the 1971 Apportionment Agreement, the imputed entitlements "necessarily established the new 'filed rate' that itself became binding on the North Carolina courts and authorities" (Alcoa Br. 24; *see also id.* at 25 n.35). Federal Amici (Br. 13) attempt to radically alter Opinion No. 139 by asserting that the NCUC "ignored the Commission's filed rate as established in the wholesale rate proceeding."[7] *See also* Tenn. Br. 2-3, 10. Alcoa at times argues that the NCUC must include all costs incurred under "FERC rate schedules and decisions" (Br. 18, 20), as if the two were the same. EEI also wavers between the two. *Compare* EEI Br. 18-20 *with id.* at 20-21. The problem is that the filed rate is *not* the same as the entitlements FERC imputed in setting rates to Nantahala's wholesale customers.

These inconsistencies demonstrate that the preemption arguments proceed from a fundamental mischaracterization

[7] *Post hoc* rationalizations offered by agency counsel in defending an agency decision on judicial review are routinely rejected by the courts. *See SEC* v. *Chenery Corp.*, 318 U.S. 80 (1943). The Federal Amici brief is entitled to even less weight, insofar as it attempts to rewrite a *prior* decision in order to preempt state decisions under review. Federal Amici's effort to drastically alter Opinion No. 139, after it has been affirmed by the Fourth Circuit and when no further review is available, is particularly egregious. If the FERC had decided Opinion No. 139 the way Federal Amici now claim, the case before the Fourth Circuit would have been significantly different.

Alcoa relies on misrepresentations offered in the Federal Amici brief, rather than on FERC Opinion No. 139. *See, e.g.*, Alcoa Br. 3 & n.2, 25 n.35.

of Opinion No. 139, as recognized by the North Carolina Supreme Court (App. 91a-98a). This is *not* a case where FERC made "cost and power allocations to North Carolina and Tennessee" (Alcoa Br. 33).[8] In Opinion No. 139, FERC left unchanged the division of TVA entitlements between Nantahala and Tapoco contained in the 1971 contract — the filed rate — but *departed* from those allocations to achieve just and reasonable rates to Nantahala's wholesale customers.[9] Rather than reviewing the inter-utility transactions as regulator of bulk power transactions, FERC in Opinion No. 139 viewed them in its role as regulator of Nantahala's rates to its three wholesale customers, a role parallel to the NCUC's role in setting Nantahala's retail rates.[10] The FERC emphasized that it was acting only in the context of establishing just and reasonable rates for wholesale customers and was not purporting to allocate interstate power flows or costs, stating that "we have not modified Nantahala's contracts [under Section 206]. Instead, we have set just and reasonable rates under our powers under Section 205." Opinion No. 139-A, App. 312a. *See also id.* at 310a-311a.[11]

[8] *See also* the erroneous proclamations of the Federal Amici that "[t]he Commission did decide, however, that adjustments were required in the 1971 Apportionment Agreement to give a somewhat bigger share of the entitlements from TVA to Nantahala . . ." (Br. 5), and that the Commission acted "by taking away some entitlements from Tapoco-Alcoa and awarding them to Nantahala . . ." (*id.* at 20).

[9] It is EEI that is confused where it attempts to characterize this as a distinction between an interstate power transaction "found just and reasonable by the FERC and one which has been merely accepted for filing by the FERC" (Br. 3-4 n.1).

[10] Compare Federal Amici's claim (Br. 9) that the "NCUC has sought to change the precise allocations established by FERC in the course of its review of the interstate arrangements."

[11] Alcoa consistently mischaracterizes the decision as making determinations under §206 establishing "cost and power allocations to North Carolina and Tennessee." Alcoa Br. 33. *See also id.* at 7, 8, 25 n.35. EEI argues that a §205 proceeding involves the FERC's authority under §206 as well (EEI Br. 18 n.13). However, in Opinion No. 139 the FERC exercised its authority to modify Nantahala's wholesale rates, rather than to modify the 1971 Apportionment Agreement.

There is no basis for adopting Alcoa's "imputed filed rate" argument and concluding that, notwithstanding contrary holdings in Opinion No. 139, the FERC intended to require the NCUC to use for retail ratemaking the same assumed entitlements that it used for wholesale rates. States in setting rates to retail customers and the FERC in setting rates to wholesale customers may use different ratemaking methodologies. *Public Systems* v. *FERC*, 709 F.2d 73, 84 (D.C. Cir. 1983). Opinion No. 139 illustrates the wide yet accepted divergence between the ratemaking policies of these two jurisdictions.[12]

Federal Amici argue that while "minor inconsistencies" between federal ratemaking applicable to a utility's wholesale customers and state ratemaking applicable to its retail customers are tolerated, this case involves allocation of "the costs of the bulk power transactions on which the company relies to obtain the power it sells to its customers . . ." (Br. 18 n.12).[13] *See also* EEI Br. 21-22. The first flaw in this argument is the view that other discrepancies between state and federal regulation are mere minor annoyances. If it were the NCUC, rather than the FERC, which disallowed Nantahala's purchased power adjustment clause ("PPAC") as inconsistent with applicable state regulations, the revenues disallowed would be very substantial.[14]

[12] The FERC rejected an NCUC-accepted treatment of amortization of Nantahala's major generating facilities (19 F.E.R.C. at pp. 61,286-87; 20 F.E.R.C. at pp. 61,872-74), and an NCUC-accepted purchased power adjustment clause (19 F.E.R.C. at pp. 61,283-85; 20 F.E.R.C. at pp. 61,871-72; 21 F.E.R.C. at p. 61,500). Their methods for determining rate base and rate of return differ significantly. *Compare* 19 F.E.R.C. at pp. 61,285-86 *with* the NCUC order, App. 222a-226a.

[13] Federal Amici proceed (Br. 18 n.12) to mischaracterize the NCUC's action as allocating costs to *customers* of a separate entity. As discussed at page 24, *infra*, North Carolina has allocated the costs not prudently incurred for the benefit of retail ratepayers to Nantahala and its stockholder, Alcoa.

[14] Or perhaps Federal Amici and EEI are suggesting that because rejection of a PPAC effectively results in refusal to pass through FERC-regulated wholesale costs, the NCUC would be preempted from enforcing its hypothetical automatic adjustment clause regulations in the way the FERC did in Opinion No. 139.

Second, and more fundamentally, the professed intolerance of Federal Amici (and EEI) of inconsistencies between state and federal treatment of bulk power transactions is inconsistent with the FERC's own regulation of such transactions. The Federal Amici have failed to inform the Court that the FERC has interpreted its responsibility under the Federal Power Act to determine the "justness and reasonableness" of bulk power transactions *not* to require inquiry into whether the transactions were prudently entered into. The FERC explicitly leaves the prudence determination to itself in setting wholesale rates, *and* to the state in setting retail rates. As explained in *Pennsylvania Power & Light Co.*, 23 F.E.R.C. ¶ 61,325 at p. 61,716 (1983) (footnote omitted):[15]

> The legislative purpose of the Federal Power Act is to ensure that the rates and terms of service for transmission and sales of electric energy subject to the jurisdiction of the Commission are just and reasonable. We have made that public interest determination here by finding that PP&L's rates under the agreement are not excessive.

[15] *Accord, AEP Generating Co.*, 29 F.E.R.C. ¶ 61,246 at p. 61,501 (1984), *motion for clarification denied*, 32 F.E.R.C. ¶ 61,364 (1985), *reh'g granted for further consideration*, November 12, 1985; *Pacific Power & Light Co.*, 27 F.E.R.C. ¶ 61,080 (1984); *Southern Company Services, Inc.*, 26 F.E.R.C. ¶ 61,360 at p. 61,795 (1984); *Southern Company Services, Inc.*, 20 F.E.R.C. ¶ 61,332 at p. 61,694 (1982); *Philadelphia Electric Co.*, 15 F.E.R.C. ¶ 61,264 at p. 61,601 (1981).

In *American Electric Power Service Corp.*, 32 F.E.R.C. ¶ 61,363 (1985) (rehearing pending), the FERC held that its determination of the justness and reasonableness of a transmission agreement that was integral to the operations of a multistate registered holding company power pool, fully subject to FERC and Securities and Exchange Commission jurisdiction, *would* preempt the states from considering the prudence of the transmission agreement. The FERC found that, in those circumstances, resolution of the transmission agreement controversies would leave nothing for the states to decide. 32 F.E.R.C. at pp. 61,817-19. Therefore, *American Electric Power Service* is not like Opinion No. 139.

> . . . We do not view our responsibilities under the Federal Power Act as including a determination that the purchaser has purchased wisely or has made the best deal available. However, these are legitimate concerns of the State commissions and this Commission as well in determining the purchaser's rates for sales to others.

Opinion No. 139 is fully consistent with this line of cases. Although the FERC left unchanged the filed agreements, it reduced Nantahala's rates to its wholesale customers to prevent the pass-through of certain costs associated with those agreements, characterizing the case as "involv[ing] the prudence of the costs incurred by Nantahala." Opinion No. 139-A, App. 312a.

Moreover, in accord with its approach concerning other prudence-related determinations, the FERC was not concerned that North Carolina might adopt a different technique to ensure that the costs passed on to retail ratepayers were prudently incurred for their benefit. Opinion No. 139-A expressly acknowledged that North Carolina applying state criteria could validly require roll-in (App. 305a):[16]

> We recognize that the North Carolina Utilities Commission (NCUC), based on a similar record, reached a different conclusion concerning rolled-in costing. However, the question of whether to treat various entities as an integrated system for ratemaking purposes is not a purely factual question, but also rests on criteria which each ratemaking authority may deem relevant.

Federal Amici improperly attempt, in a brief filed long after Opinion No. 139 was affirmed by the Fourth Circuit, to reverse this finding in FERC's decision by terming it "a casual remark of the Commission . . . that may have failed adequately to

[16] Contrast Federal Amici's assertions that the NCUC was the wrong forum for the disputes it addressed, because "the broader perspective of the federal authority" was required (Fed. Br. 11; *see also id.* at 9, 21).

distinguish the separate considerations involved in these two types of situations [allocations of costs within a single company as compared with the costs of bulk power transactions]." Fed. Br. 19 n.12. This belated effort to rewrite Opinion No. 139 not only is entitled to no weight, but is contrary to FERC's consistent interpretation of its statutory responsibilities in determining the justness and reasonableness of bulk power transactions. *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969), incorrectly cited by Alcoa (Br. 29) to demonstrate that the FERC's "reinterpretation" of Opinion No. 139 is entitled to deference, actually applies to an agency's longstanding interpretation of its statute in its *orders*. The FERC's interpretation of its statutory role in Opinion No. 139 and the *Pennsylvania Power & Light Co.* line of cases is entitled to deference. Federal Amici's new attempt to preempt state regulation merely by invoking "the Commission's exclusive jurisdiction over . . . bulk power transactions" (Br. 19 n.12) is not.[17]

EEI's "imputed filed rate" argument that in determining Nantahala wholesale rates the FERC necessarily determined "a just and reasonable allocation of entitlements and costs" (Br. 19) is without merit. To require the NCUC to adhere to the precise entitlements that the FERC attributed to Nantahala would be to single out one of the package of adjustments ordered by the FERC to achieve what it found to be just and reasonable wholesale rates under the Federal Power Act. For example, the FERC disallowed Nantahala's PPAC, which

[17]Even less convincing is EEI's claim (Br. 23) that "the FERC typically does not use rate orders to instruct state commissions on the preemption doctrine." While EEI (unlike some of its allies) correctly recognizes the wholesale ratemaking context of Opinion No. 139 and while its argument might make some sense if FERC had been silent with regard to the NCUC's roll-in order, it makes no sense where the FERC *did* speak clearly on the preemption issue, in a manner fully consistent with its precedent, in answer to arguments made by the North Carolina Attorney General, among others. Moreover, as shown in *American Electric Power Service Co.*, where the FERC concludes that the *Pennsylvania Power & Light Co.* principle should not be applied because of special circumstances, it says so. Thus, the FERC cases adequately address Alcoa's

prevented Nantahala from recovering all of the TVA power costs remaining after taking account of the additional, imputed entitlements.[18] Would the NCUC also be required to reject Nantahala's retail PPAC, which was otherwise acceptable under North Carolina standards? The FERC's imputed entitlements no more bind the NCUC than the FERC's choice of rate of return.

Even less tenable is the argument that the filed rate doctrine precludes the NCUC from allocating costs to the public on a basis other than the literal terms of the 1971 Apportionment Agreement. NEES in effect claims that while the FERC can decline to follow the filed rate so as to make wholesale rates just and reasonable under the Federal Power Act, North Carolina cannot treat the same agreements in the same manner to achieve what it concludes are just and reasonable retail rates. The FERC did *nothing* to protect Nantahala's retail customers; Opinion No. 139 explicitly left that to the State. A ruling now, after Opinion No. 139 has been affirmed by the Fourth Circuit, that the decision did not do what it said it did would leave retail ratepayers completely unprotected from what both Federal and North Carolina authorities found to be unreasonable costs.[19]

In setting rates to wholesale customers, the FERC is as bound by the filed rate doctrine as is a state commission. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 578 (1981); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956). Because that doctrine did not prevent FERC from setting wholesale rates on a basis other than the entitlements agreed to by the affiliated companies, it does not preclude the NCUC from allocating the Nantahala/Tapoco total system costs on another basis as well.

alleged concern that states might make prudence determinations that subvert the national interest (Alcoa Br. 29 n.41).

[18]Federal Amici's assertion (Br. 5) that the "[r]ates to Nantahala's wholesale customers thus reflect the respective costs of its entitlements and its purchased power" is not true.

[19]NEES' argument (Br. 18) that the NCUC's exclusive remedy is with the FERC therefore rings hollow. *See also* Alcoa Br. 19, 22, Fed. Br. 11.

Indeed, *Pennsylvania Power & Light Co.* and its progeny explicitly contemplate departure from the filed rate when the FERC and the states independently review the transaction for prudence. For example, in *Pacific Power & Light Co.*, 27 F.E.R.C. ¶ 61,080 (1984), the FERC refused to consider the feasibility or prudence of a proposed arrangement in reviewing its justness and reasonableness. Even though the filed rate therefore will remain unchanged, the FERC found that "[t]he proper forum for [wholesale customers' prudence] concerns is a [wholesale] rate case. . . ." 27 F.E.R.C. at p. 61, 148. Under NEES' interpretation of the Federal Power Act, there would be no forum for considering retail customers' prudence concerns. The small percentage of a utility's ratepayers that purchase at wholesale cannot possibly be the only consumers lawfully entitled to the protection of a prudence review of the utility's actions.

Thus, Opinion No. 139 did not bind the NCUC to rigid application either of the filed rate that the FERC itself found unfair, or of the imputed entitlements approach that the FERC adopted to set rates for Nantahala's wholesale customers only.

B. The NCUC and North Carolina Supreme Court Decisions Thus Are Entirely Consistent with This Court's Decisions and With the *Narragansett* Doctrine

The North Carolina decisions under review affect only Nantahala's *retail* rates. In no way do they interfere, directly or indirectly, with the FERC's regulation of Nantahala's *wholesale* rates. Thus, the decisions of this Court that address state interference with federal wholesale ratemaking are inapposite. *Maryland* v. *Louisiana*, 451 U.S. 725 (1981), which Alcoa asserts "is dispositive" (Br. 23), struck down a State tax on natural gas transmitted by interstate pipelines into the State from offshore wells in the federally-owned Outer Continental Shelf, primarily for sale in other states. The State's requirement that the tax be borne by the pipelines or their customers hindered the FERC's authority under the Natural Gas Act to regulate the rates at which the pipelines sold the gas for resale,

and in fact was inconsistent with the FERC's ratemaking methodology. 451 U.S. at 748-50. In *Northern Natural Gas Co.* v. *State Corporation Comm'n of Kansas*, 372 U.S. 84 (1963), the State interfered with federal regulation of the wholesale sales of interstate pipelines under the Natural Gas Act by ordering interstate pipelines to rateably purchase gas from wells within the State.[20]

Preemption of state regulation of *retail* electric rates is a different matter entirely. The Federal Power Act expressly reserved for the states the regulation of retail rates and services. 16 U.S.C. §§824(a) and (b)(1). A state's regulation of retail transactions is limited by the filed rate doctrine. Thus, numerous cases have articulated the "*Narragansett* doctrine,"[21] which holds that state regulation must give effect to a retail utility's purchased power costs incurred under a FERC-regulated wholesale rate, whether the FERC decision has issued or is pending, and cannot interfere with or defy an actual or potential FERC interstate allocation of power costs.

However, Opinion No. 139 did *not* allocate power costs between Nantahala's ratepayers in North Carolina and Tapoco's ratepayer (Alcoa) in Tennessee.[22] Nor did it set just and reasonable purchased power expenses for Nantahala which must be allowed by the NCUC.[23] Because the FERC has acted and,

---

[20] *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Board*, 54 U.S.L.W. 4114 (U.S. Jan. 22, 1986), reaffirmed *Northern Natural Gas* under similar facts, and held that the Natural Gas Policy Act of 1978 did not delegate to the states the authority to order such transactions.

[21] *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

[22] This distinguishes the instant case from *Northern States Power Co.* v. *Minnesota Public Utilities Comm'n*, 344 N.W. 2d 374 (Minn.), *cert. denied*, 104 S. Ct. 3546 (1984); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981); *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 593 F. Supp. 363 (E.D. Ark. 1984), *aff'd on other grounds*, 772 F.2d 404 (8th Cir. 1985), *cert. denied*, 54 U.S.L.W. 3498 (U.S. Jan. 28, 1986).

[23] This distinguishes the instant case from *Narragansett Electric Co.* v. *Burke*, *supra*, and from *Eastern Edison Co.* v. *Dept. of Public Utilities*,

in acting, declined to preempt North Carolina's regulation of Nantahala's retail rates, the *Narragansett* cases, which struck down state decisions inconsistent with actual or potential FERC decisions, are inapposite.

In *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985), the court reversed the retail commission for accepting without scrutiny a utility's power purchases from its parent, which included the costs of cancelled nuclear plants. The court held that although the state commission could not inquire into the reasonableness of the FERC-determined wholesale rate, "the PUC may always inquire into the reasonableness of a utility's purchasing power under a FERC-approved rate given other purchase options available to the utility." 498 A.2d at 699. After discussing the *Pennsylvania Power & Light Co* line of cases, the court expressed the preemption doctrine as precluding

> examin[ation of] those matters *actually determined*, whether expressly or impliedly, by the FERC. As to those matters not resolved by the FERC, State regulation is *not preempted provided that* State regulation would not contradict or undermine FERC determinations and federal interests, or impose inconsistent obligations on the utility companies involved.

Id. at 704 (emphasis in original). The court concluded that the pertinent FERC orders did not preempt the state commission from determining the "reasonableness or prudency" of the utility's purchases. *Id.* at 704-05. *See also Pike County Light and Power Co.* v. *Pennsylvania Public Utility Comm'n*, 77

388 Mass. 292, 446 N.E.2d 684 (1983); *Public Service Co. of Colorado* v. *Public Utilities Comm'n*, 644 P.2d 933 (Colo. 1983); *Washington Gas Light Co.* v. *Public Service Comm'n*, 452 A.2d 375, 384-86 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983); *Office of Public Counsellor* v. *Indiana & Michigan Electric Co.*, 416 N.E. 2d 161, 164-65 (Ind. App. 1981); *United Gas Corp.* v. *Mississippi Public Service Comm'n*, 240 Miss. 405, 127 So.2d 404, 418-21 (1961); *City of Chicago* v. *Illinois Commerce Comm'n*, 13 Ill.2d 607, 150 N.E. 2d 776, 780-81 (1958); *Citizen Gas Users Ass'n* v. *Public Utilities Comm'n*, 165 Ohio St. 536, 138 N.E.2d 383 (1956).

Pa. Commw. 268, 465 A.2d 735, 737-38 (Pa. Commw. Ct. 1983).[24] No case in the *Narragansett* line has reversed a state commission for disallowing purchased power costs incurred under a FERC-filed rate schedule, on grounds of prudence or need for the power in question, when the FERC had left such an inquiry open to the state.[25]

The instant case illustrates the principle underlying *Sinclair*. Opinion No. 139 did not modify the 1971 Apportionment Agreement, but disallowed certain costs associated with that contract as not prudently incurred by Nantahala, and thus as not properly borne by Nantahala's *wholesale* customers; therefore, those costs were borne by Alcoa, as Nantahala's sole shareholder. *See* Opinion No. 139-A, App. 308a-309a, 312a. The NCUC determined that Nantahala was not even capable of prudent action on behalf of its ratepayers. It found Nantahala not to be an independent utility under North Carolina law, because it was developed as part of a single system by Alcoa and completely subjected to Alcoa's domination. Thus, it imposed Nantahala's refund obligation on Alcoa. *See* the NCUC's order, App. 233a. EEI's argument that the cases leaving questions of prudence and need for power to the states are not applicable to the NCUC's decision "because the prudence of Nantahala's power supply arrangements . . . is not questioned" (EEI Br. 14 n.10) is meritless.

[24] *Accord, Spence* v. *Smyth*, 686 P.2d 597, 600 (Wy. 1984).

[25] Alcoa points out (Br. 27) that *Northern States Power Co.* v. *Hagen*, *supra*, 314 N.W.2d at 38, held that the questions of "reasonableness and prudence" addressed by the state commission must be litigated at the FERC. In that case, the state commission had disallowed abandoned nuclear plant costs that the FERC had expressly allocated between affiliated utilities operating in different states, in the context of approving as just and reasonable an amended coordination agreement that allocated those costs. *Northern States Power Co.* v. *Hagen*, *supra*, 314 N.W.2d at 34. *See also Northern States Power Co.* v. *Minnesota Public Utilities Comm'n*, *supra*, 344 N.W.2d at 375-76.

Federal Amici blur the distinction between cases in which the FERC has allocated costs between utilities and between states, and a FERC wholesale rate case, by misleadingly characterizing the *Northern States Power Co.* cases as involving a utility's "rate design" as distinct from its "revenue requirement" (Fed. Br. 16-17). Actual FERC "rate

Federal Amici and Alcoa attempt to avoid *Sinclair* and *Pike County* by ignoring the line of FERC cases on which *Sinclair* relies, and by insisting that Opinion No. 139 left nothing for North Carolina to decide (Fed. Br. 19-20; Alcoa Br. 28 n.41).[26] Alcoa argues that this Court should hold that "a State may not disallow [purchase power] costs . . . unless a filing has been made with FERC *and* FERC has made it explicit that it has not found the local utility's contractual arrangement to be prudent and in the overall public interest" (Br. 29 n.41, emphasis in original). Whatever the general merits of Alcoa's suggestion, this is exactly what happened in Opinion No. 139.

NEES' argument that Nantahala's power supply can be conceptualized as a "rate" paid to Nantahala for its sale of its hydroelectric output to TVA,[27] and that "[n]o one has argued that FERC lacks jurisdiction to investigate the prudence of a seller's rates under the Federal Power Act," is pure sophistry (NEES Br. 15 n.9; *see also id.* at 6). Here, the FERC determined not to address matters concerned with the reasonableness of Nantahala's power supply for its retail customers; those matters were addressed by the NCUC.

NEES also argues that *Pike County* and *Sinclair* were wrongly decided because the FERC *must* determine all questions related to the reasonableness and prudence of a utility's bulk power supply (Br. 15 n.9). *See also* EEI Br. 18-20. This radical attempt to preempt state retail regulation flies in the face of the FERC's interpretation of the Federal Power Act, and would, if adopted, render a number of FERC decisions, including Opinion No. 139, in violation of the Federal Power

design" determinations, made in a wholesale rate case, do not bind state retail commissions. For instance, the FERC and the NCUC reached different conclusions on Nantahala's PPAC, a true rate design issue.

[26] The Federal Amici also attempt to supplement Opinion No. 139 with conclusions about Nantahala's power supply that are not in the decision itself (Fed. Br. 20).

[27] Contrast Opinion No. 139-A's examination of the "discrepancy in the rates paid by Nantahala and Tapoco" to TVA (App. 307a).

Act.[28] In this case, the result of NEES' argument is absurd as well as unjust: imposition on retail customers of costs that the FERC found unfair and refused to impose upon wholesale customers. Moreover, this result would be inconsistent with the thrust of *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Comm'n*, 461 U.S. 375 (1983), where the Court held that the states are not preempted from regulating the wholesale sales of rural electric cooperatives, when the FERC had determined that it did not have jurisdiction over such sales. The Court declared that "Congress' purpose in [enacting the Federal Power Act in] 1935 was to fill a regulatory gap, not to perpetuate one." 461 U.S. at 384. The Court also concluded that the FERC had not determined that the transactions at issue should be unregulated. *Id.* at 384-85.

The arguments that the NCUC was preempted from using roll-in to pierce the corporate veil have no support. The NCUC did not use roll-in to defeat or disallow any FERC allocation of costs to North Carolina or Nantahala; there was no such FERC allocation.[29] The FERC's rejection of roll-in for setting Nantahala's wholesale rates did not have the purpose or effect of allocating costs between utilities or states. Thus, the cases on which EEI and Alcoa rely (EEI Br. 13-15 & n.11; Alcoa Br. 33 n.46) are inapplicable here.[30]

[28] Federal Amici, understandably, do not take this self-defeating position; rather, they mischaracterize Opinion No. 139 and ignore the FERC decisions that it resembles.

[29] In a puzzling discussion of *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581 (1945), NEES appears to argue that the NCUC attempted to use roll-in to eliminate Nantahala and Tapoco, and thus to eliminate the 1971 Apportionment Agreement as a wholesale arrangement under FERC's jurisdiction (*see* NEES Br. 7-8). Alcoa appears to make a similarly absurd suggestion (*see* Br. 11 and n.16).

[30] ***Sinclair Machine Products, supra***, 498 A.2d at 706, held that the state commission could not use a piercing of the corporate veil rationale to disallow flow-through of abandoned nuclear plant costs that the FERC had determined should be flowed from one utility to its retail subsidiary. ***Office of Public Counsellor*** v. ***Indiana and Michigan Electric Co., supra***, 416 N.E. 2d at 164-65, held that where the FERC regulated sales to a utility by its nuclear generation subsidiary, a state could not use roll-in to reduce the FERC-determined rate of return received by

C. Preemption of the North Carolina Decisions Now Would Result in Confusion and Injustice

The picture that Alcoa and various amici paint of the FERC as the sole regulator of all retail rate effects of bulk power agreements is wrong. In accord with the FERC's normal practice, Opinion No. 139 did not preempt the NCUC from inquiring into the prudence of Nantahala's power supply arrangements. Because this was not a case in which the FERC concluded that it must decide interstate, inter-utility cost allocations in light of interstate controversies, a preemption ruling here would require this Court to hold that Opinion No. 139 itself, and numerous other FERC decisions that have reserved questions of prudence and need for power for retail and wholesale rate cases, are in violation of the Federal Power Act. Such a result would leave Nantahala's retail customers with no relief at all. In addition, in numerous other cases not before this Court, the FERC has left retail ratepayers with no forum to resolve questions of prudence and reasonableness of power supply options except state commissions.

This case is but a stage in a longstanding and unique controversy between the Alcoa family and the public served by Nantahala. The broad policy considerations advanced in support of preemption are inapplicable here. Alcoa and others argue that the system of federal-state electric regulation resulting from the Federal Power Act is endangered when a state disregards or relitigates determinations made by the FERC, or when retail electric regulation in two or more states clashes, or imposes inconsistent obligations on an interstate system or utility. The decisions under review do not conflict with binding FERC determinations in Opinion No. 139. To be sure, the NCUC and the FERC, after their prudence-related investigations, reached different decisions as to the amount of costs that should be allocated from ratepayers to Nantahala's shareholder, Alcoa. However, this result is no more barred by the

---

the subsidiary. More generally, a state cannot disregard or disallow costs incurred under FERC-jurisdictional rate schedules *merely* because the wholesale transactions involve affiliates. *See, e.g., United Gas Corp.* v. *Mississippi Public Service Comm'n, supra*, 127 So. 2d at 420.

Federal Power Act and the Supremacy Clause than are differing conclusions of regulatory commissions as to the prudence of a utility's coal contract.

Also irrelevant are the speculations as to the consequences if Tennessee were to regulate Tapoco's rates, or if Tapoco were to serve others besides Alcoa in Tennessee (Alcoa Br. 30; Tenn. Br. 11; EEI Br. 12-13 and n.9, 23). The Tennessee Public Service Commission has never regulated and does not regulate Tapoco's rates to Alcoa. With regard to Tapoco/Alcoa, Tennessee's concern is with jobs, not with electric regulation within its borders.[31] Neither Tennessee nor anyone else has explained how or why Tennessee would regulate Tapoco's rates.

In light of Opinion No. 139, the FERC's interpretation of its statutory mandate, and the unique facts of this case, the North Carolina decisions should stand.

II. THE NCUC'S ORDERS DO NOT VIOLATE THE COMMERCE CLAUSE

The Commerce Clause arguments of Alcoa and its allies arise from the premise that the NCUC reallocated costs from the North Carolina public load to Tennessee or to "Tapoco's Tennessee customers" to give North Carolina a preference to the low cost hydroelectric power. *See, e.g.*, Alcoa Br. 11-15. This completely misconstrues the nature of the NCUC's orders

---

[31] Tapoco's sales to Alcoa are regulated by the FERC as a rate schedule of a hydroelectric licensee under Part I of the Federal Power Act (16 U.S.C. §§812 and 813; *see also* 18 C.F.R. §35.21 (1985)), and were not at issue in, or affected by, the FERC orders pertinent here (App. 309a). The 1955 Tennessee Commission order to which Tennessee refers (Br. 11) merely asserted a right to require Tapoco to submit to its jurisdiction.

Although Tennessee asserts that it "has had no opportunity to participate in the decisions at issue" (Br. 7), it submitted an *amicus* brief to the North Carolina Supreme Court, and its arguments were considered (App. 10a, 106a). Tennessee complains that the North Carolina Court of Appeals denied its motion to file an *amicus* brief (Br. 15); that motion was submitted a month out of time.

and, in particular, the NCUC's explicit determination to hold Alcoa, *as Nantahala's dominating stockholder*, not as Tapoco's customer, responsible for manipulating its public utility subsidiaries to the detriment of the North Carolina public.

The NCUC's retail rate order neither intended nor resulted in economic protectionism or regulation of interstate commerce. The NCUC's establishment of retail rates by combining the costs of Nantahala and Tapoco, and allocating to the public its proportionate share of the joint costs — as it does for every other utility operating in more than one state (*see* the North Carolina Supreme Court's discussion, App. 16a, 101a) — rested on factual findings well within the traditional purview of a retail commission. Roll-in was based on findings, as affirmed and summarized by the North Carolina Supreme Court, that Tapoco and Nantahala are North Carolina public utilities and that

> (a) Nantahala has not been designed, developed and operated as a stand-alone electric system, (b) the Nantahala and Tapoco electric facilities constitute a single integrated electric system, and (c) the two corporate affiliates should be treated as a single utility system for rate making purposes, in view of their historical development, actual operating conditions and the fact that Nantahala's customer cost responsibility cannot be accurately determined using a "stand-alone" model. . . .

App. 136a-137a. The NCUC's decision found that Alcoa dominated Nantahala, sō that Nantahala was incapable of protecting its ratepayers, and therefore pierced the corporate veil to hold Alcoa, as Nantahala's stockholder, responsible for the refunds which exceeded Nantahala's ability to pay (*id.* at 233a).[32]

[32] Federal Amici's characterization of the NCUC's action as "not . . . disallow[ing] the costs at issue here, [but] simply . . . shift[ing] them to the out-of-state customer of the other utility" (Br. 16 n.11) is the opposite of what the NCUC did, and is in no way supported by the citation they offer (to App. 86a). Their suggestion that disallowance of costs would result in confiscatory rates is not before this Court (*see* Supreme Court Rule 15.1(a)) and is inconsistent with the FERC's actions in

When the interests of a regulated company are subordinated to an affiliate so as to benefit private interests to the injury of the public the regulatory scheme was designed to protect, it may be appropriate or necessary to pierce the corporate veil to halt and redress the injury.[33] The NCUC acted appropriately under North Carolina law to protect retail ratepayers because Alcoa has not behaved as a mere investor in Nantahala, but rather has manipulated Nantahala and Tapoco to procure for itself low-cost power.[34]

State commissions plainly may act to protect ratepayers from imprudent actions of public utilities, utility acquisitions that are not used and useful for retail ratepayers, or unreasonable costs imposed by inter-affiliate manipulations. Any disallowance of costs will have an impact on the company and its stockholders. The geographical location of the stockholders and their other interests does not implicate the Commerce Clause.

Nor does the Commerce Clause prevent the NCUC from effectively regulating these North Carolina public utilities simply because Alcoa located its unregulated smelting operations across the state line from the public it exploited. Nothing in the North Carolina decisions suggests that they would have been decided differently if Alcoa's plant were in North Carolina. Because Opinion No. 139 did not preempt the NCUC's

Opinion No. 139 with respect to both the "imputed" entitlements and the disallowance of Nantahala's PPAC.

[33] *See, e.g., Colorado Interstate Gas Co.* v. *FPC, supra*, 324 U.S. at 606-08; *United Fuel Gas Co.* v. *Railroad Comm'n of Kentucky*, 278 U.S. 300, 320-21 (1929); *Chicago, Milwaukee & St. Paul Ry.* v. *Minneapolis Civic & Commerce Ass'n*, 247 U.S. 490, 500-01 (1918). *See also* the North Carolina Supreme Court's discussion, App. 113a.

[34] *See* the North Carolina Supreme Court's discussion, App. 113a-122a. *See also United States* v. *Reading Co.*, 253 U.S. 26, 48, 60-63 (1920); *Chicago, Milwaukee & St. Paul Ry.* v. *Minneapolis Civic & Commerce Ass'n, supra*, 247 U.S. at 500-01. Indeed, the North Carolina Supreme Court held that the statute that makes Alcoa a North Carolina public utility insofar as its ownership and control of Nantahala affects the latter's rates is designed to facilitate review and remedy of such abuses as were found in this case (App. 110a-112a).

roll-in and left protection of retail ratepayers to the State, Alcoa's argument amounts to no more or less than an effort to eliminate *any* forum where it can be forced to bear the consequences of its actions as they have affected 93% of Nantahala's load.[35]

Moreover, the NCUC's orders have only an incidental effect on interstate commerce. They are directed against Nantahala in the first instance, and are an unexceptional example of a state disallowing costs not incurred for the benefit of ratepayers. The NCUC went on to pierce the corporate veil, to require Alcoa to pay refunds exceeding Nantahala's ability to pay, but it expressly stated that this neither required nor contemplated any effect on Tapoco's rates to Alcoa (App. 241a, 243a). That Alcoa is both Nantahala's stockholder and Tapoco's customer, and that Alcoa's purpose in manipulating its subsidiaries has been to obtain benefits through Tapoco's sales to Alcoa's smelter, does not make refunds a cost of purchasing Tapoco power.

Thus, the NCUC's orders do not impermissibly interfere with interstate commerce under the standards set forth in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970). Where a state "regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." 397 U.S. at 142. The incidental burden on interstate commerce here cannot outweigh North Carolina's strong interest in effective utility regulation. *See, e.g., Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Comm'n, supra*, 461 U.S. at 377, 394-95.

In *Western Distributing Co.* v. *Public Service Comm'n*, 285 U.S. 119 (1932), a case whose facts were close to those of *Narragansett Electric Co.* v. *Burke, supra*, the Court held that

[35] This is not a case where FERC review provided the "same substantive protections" as NCUC review, or where the NCUC simply provided additional protections that "go beyond" those provided by the FERC, as claimed by Alcoa (Br. 39, *quoting Edgar* v. *MITE Corp.*, 457 U.S. 624, 644-45 (1982)).

the Commerce Clause did not bar a state from inquiring into the reasonableness of the costs of a local gas distribution company's purchases from its affiliate under an interstate gas rate. The Court ruled that such an inquiry was vital to effective state regulation of intrastate retail rates, and that it did not constitute an impermissible regulation of interstate commerce. 285 U.S. at 124-25. The *Western Distributing Co.* case was decided prior to the enactment of the Federal Power Act of 1935, when there was no regulation of interstate wholesale sales. In the instant case, the FERC explicitly left it open to North Carolina to protect retail customers from Nantahala's imprudence in its transactions with affiliates. Thus, *Western Distributing Co.* supports the inquiry undertaken by the NCUC here.[36]

The NCUC's actions are not at all comparable to the economic protectionism held unconstitutional in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982) ("NEPCO"). The NCUC did not prohibit the export of North Carolina hydroelectric power, or the economic benefits of such power, so as to retain it for in-state residents. The NCUC only established Nantahala's retail rates in a manner which assures Nantahala ratepayers a fair allocation of the Nantahala/Tapoco total system costs and does not disproportionately burden them with the costs of Alcoa's manipulations. In contrast to *NEPCO*, no wholesale sales were ordered, and no changes in wholesale rates were the necessary consequence of the NCUC's orders.[37] Moreover, in *NEPCO*, the loss a utility would incur if it continued to sell hydroelectric power out-of-state served no legitimate (non-protectionist) state interest. There *is* an important state interest in requiring Alcoa, Nantahala's stockholder, to bear the costs it caused Nantahala to incur for its benefit.

[36] Federal Amici appear to agree that if the NCUC's orders are not protectionist (which they are not), they may well pass muster under *Bruce Church* (Fed. Br. 24). In essence, they are suggesting that this Court use this case to overrule its recent Commerce Clause decisions (*see id.* at 24-25). However, their suggestion that the Court return to "pre-[Federal Power] Act Commerce Clause cases" (*id.* at 25) might not have the result they seem to think.

[37] Tennessee is wrong when it asserts (Br. at 8) that the issue in *NEPCO* was a state's establishment of retail rates. *See* 455 U.S. at 335-36.

In *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 772 F.2d 404 (8th Cir. 1985), *cert. denied*, 54 U.S.L.W. 3498 (U.S. Jan. 28, 1986), the Arkansas commission explicitly sought to defy FERC orders requiring Arkansas Power & Light Company to share with its affiliates in other states the costs of a nuclear project. The NCUC's effort to protect public ratepayers from what it found to be the detrimental effects of Alcoa's dominance thus is not comparable to the Arkansas commission's efforts to keep high-cost power out of Arkansas.

Alcoa and its allies place great emphasis on the NCUC's "first call" language in their effort to portray the NCUC's actions as economic protectionism. As explained by the North Carolina Supreme Court (App. 101a-103a), this language is neither the basis for nor the effect of the NCUC's orders.

Alcoa points to the NCUC's refusal to roll-in Alcoa's separate TVA purchases (Br. 12). However, even Alcoa characterizes these purchases as among the sources of power for "Nantahala and Tapoco/Alcoa", not for the integrated Tapoco/Nantahala system the NCUC was addressing (Br. 4 n.5). As found by the NCUC, TVA's direct sales to Alcoa are not part of Tapoco's utility operations (contrary to the impression Alcoa seeks to convey at Br. 3), and even if they were, the cost of such specialized purchases would be separately assigned to Alcoa under standard allocation methodology (*see* the North Carolina Supreme Court at App. 65a-66a, and the NCUC at App. 211a-215a).[38]

Alcoa next complains that the NCUC's allocation of the Nantahala/Tapoco costs on the basis of Nantahala's "ever-increasing" demand for power somehow constitutes a "first call" on hydroelectric power (Br. 13). There is nothing extraordinary about allocating system costs on the basis of load (*supra* at page 24.). That Nantahala's load is increasing as compared with Alcoa's partial requirements purchases from Tapoco simply means that *if* this same methodology is applied in the future, Nantahala's ratepayers gradually will bear a greater proportion of the costs of all Tapoco/Nantahala resources (which will gradually include more TVA purchases). The NCUC's refusal to allocate costs on the basis of Nantahala's contribution to TVA, determined by Alcoa through its manipulation of the hydroelectric properties and of contracts the NCUC found detrimental to Nantahala, evinces protection of ratepayers from abuse rather than economic protectionism.

[38] Alcoa claims (Br. 15 n.27) that the NCUC's refusal to roll-in Alcoa's purchases is inconsistent with its holding that Alcoa is a North Carolina public utility. The NCUC's October 3, 1980 order with regard to Alcoa's public utility status (which, although a part of the NCUC's order (App. 179a), was omitted from Alcoa's Appendix) is premised on the finding that Alcoa's affiliation with Nantahala affects rates. That finding has nothing to do with the ratemaking treatment of Alcoa's separate TVA purchases.

Nor was it economic protectionism for the NCUC to use the Nantahala/Tapoco system capacity rather than the NFA entitlements as the basis for its allocations, contrary to Alcoa's claims (Br. 13-14). The NCUC found that in the NFA, Alcoa traded away the much larger system capacity of Nantahala and Tapoco to obtain entitlements peculiarly suited to its needs and of no value to Nantahala's public load (*see* the North Carolina Supreme Court's discussion at App. 67a-68a, 102a-103a).[39] The NCUC's determination not to charge ratepayers for this Alcoa trade does not constitute economic protectionism.

The NCUC's orders serve legitimate and substantial local interests with only incidental and not excessive effects on interstate commerce. They in no way violate the Commerce Clause.

[39] Alcoa mischaracterizes this trade as mere "banker's" services provided by TVA (Br. 5 n.7).

CONCLUSION

The judgment of the Supreme Court of North Carolina should be affirmed.

Respectfully submitted,

RODERIC G. MAGIE
Mayer & Magie
P.O. Box 750
Highlands, N.C. 28741
(704) 526-3731

JAMES N. HORWOOD
Counsel of Record
CYNTHIA S. BOGORAD
P. DANIEL BRUNER
Spiegel & McDiarmid
1350 New York Avenue, N.W.
Washington, D.C. 20005-4798
(202) 879-4000

Attorneys for the Town of Highlands, North Carolina

February 22, 1986